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Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1284

CLARENCE O. DUPUY, JR.,
Relator,

versus

MILTON E. DUPUY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1977

No.

CLARENCE O. DUPUY, JR.,
Relator,
versus
MILTON E. DUPUY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The petitioner, Clarence O. Dupuy, Jr., respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered May 9, 1977, rehearing denied June 6, 1977, reversing a judgment notwithstanding the verdict and alternative new trial entered by the trial judge in favor of Relator, and remanding the case for retrial limited to the issue of damages. This case involves questions of far-reaching importance in the field of federal securities laws, particularly Section 10(b) of the Security and Exchange Act of 1934, 15 U.S.C. §78j(b).

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit in Proceedings No. 76-2667 of that Court, entitled "Dupuy v. Dupuy" is reported at 551 F.2d 1005; copies of the Court of Appeals judgment, opinion, and notice of denial of rehearing are appended. The Federal District Court for the Eastern District of Louisiana issued no written opinion in support of its judgment, a copy of which is appended; Relator has appended a copy of a transcript of the trial judge's oral reasons for judgment, issued from the bench, June 9, 1976.

Shortly after the filing of the initial petition by respondent, the District Court dismissed on Relator's Motion for Summary Judgment for Lack of Federal Jurisdiction; the District Court's opinion regarding the granting of summary judgment is reported at 375 F. Supp. 730 (E.D.La. 1975). The United States Court of Appeals for the Fifth Circuit reversed said granting and remanded for trial; the Court of Appeals opinion regarding the reversal of summary judgment is reported at 511 F. 2d 641 (5th Cir. 1975). The issue that is the subject of these two opinions is not involved in this application.

JURISDICTION

This Court has jurisdiction pursuant to United States Code Title 28, Section 1254(1), authorizing review of cases in the Court of Appeals by this Court by writ of certiorari before or after the rendition of judgment or decree. The judgment sought to be reviewed is that contained in the decision of the United States Court of Appeals for the Fifth Circuit, entered May 9, 1977, in the matter entitled "Dupuy v. Dupuy", No. 76-2677 on the docket of that Court, rehearing of which was denied on June 6, 1977.

Federal jurisdiction was invoked by the plaintiff, respondent herein, pursuant to the provisions of the Securities and Exchange Act of 1934, as amended, Section 10(b), 15 U.S.C.A. §78j(b) (1970), and under Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5 (1976), prohibiting manipulative or deceptive practices, through use of a means or instrumentality of interstate commerce, or of the mails, in connection with purchase or sale of any security. On motion for summary judgment, the trial court dismissed the complaint on the basis that intrastate use of the telephone was insufficient to meet the statutory requirement of use of a means or an instrumentality of interstate commerce. As above stated, the United States Court of Appeals for the Fifth Circuit reversed and remanded for trial and this decision was not the subject of further appeal.

QUESTIONS PRESENTED

Due Diligence On The Part Of Plaintiff

1. Whether plaintiff must prove, for the protection of his own interests and as a requisite for the maintenance of the judicially-created private right of action under Section 10(b) of the Securities Exchange Act and Rule 10b-5, minimum standards of diligence, and, if so, to what degree must diligence be exhibited

and by what rule is the conduct of plaintiff to be measured.

2. Whether a Section 10(b) action is available to a plaintiff upon a mere showing that he did not act with intentional or reckless disregard of known facts in failing to investigate the factors affecting the value of stock sold by him or whether, in a face-to-face transaction, a seller, who is a director and president of a closely-held corporation, who has realistic and meaningful access to information that would have disclosed the state of facts affecting value but who was only exerting pressure for an immediate sale, must additionally show that he acted as a "reasonable investor exercising due care in light of all the facts."

3. Whether the standard of recklessness as described in 2, above — that is, the *intentional* or *reckless* disregard of *known* factors, as defined by the United States Court of Appeals for the Fifth Circuit in the decision complained of herein — is the correct standard to be applied to plaintiff in private actions under Section 10(b) of the Securities Exchange Act and Rule 10b-5, considering that previous and different standards of conduct have heretofore been imposed, and further considering that the imposition of said new standards will have the inevitable effect of an "inexorable broadening of the class of plaintiffs" in 10b-5 actions, declared to be a matter of concern by this Court as tending to "ultimately result in more harm than good." in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. at 747-748, 95 S. Ct. at 1931, 44 L. Ed. 2d at 556 (1975), and in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976).

4. Whether, if said newly imposed standard is correct, the United States Court of Appeals for the Fifth Circuit erred in holding that the trial judge abused his discretion in holding that the jury had no reasonable basis for finding even a minimal standard of due diligence.

Scienter On The Part Of Defendant

5. Whether "recklessness" on the part of a defendant, in a Rule 10b-5 action, is sufficient to supply the required element of scienter in accordance with the decision of this Court in *Ernst & Ernst, supra*.

6. Whether the Trial Court correctly instructed the jury as to the criteria for liability by charging in the following language:

> "To complete his proof that the defendant acted in an unlawful manner, the plaintiff must show that the misrepresentations and/or omissions were done knowingly, *or that such acts were done recklessly*." (Emphasis supplied.)

7. Whether the Trial Court instructed the jury correctly as to the requirement of scienter to impose liability when it instructed the jury on the term "reckless" in the following language:

> "An act is done recklessly when done in conscious disregard of, or with indifference to, the risk that the plaintiff would be misled. If a person makes a misrepresentation without know-

> ing whether it is true or not, or makes it without regard to its truth or falsity, or to its possible consequences, he may be found to have made the representation recklessly . . ."

8. Whether the issue of the sufficiency of the trial judge's charge on scienter was properly presented to the Circuit Court of Appeals for review when the issue was briefed and argued by Relator (Appellee below) as an additional ground on which a new trial should have been granted, although no cross-appeal was taken by Relator from the District Court following that Court's granting of judgment notwithstanding the verdict and conditional new trial in favor of Relator, which conditional new trial was granted on grounds other than the error in the jury instructions pertaining to scienter.

Remand On Limited Issue

9. Whether the Court of Appeals properly limited the issue on remand solely to the subject of quantum of damages in view of the trial court's ordering a new trial without limitation of issue in the following language:

> "It is further ordered, adjudged and decreed that the alternative motion for a new trial made by Clarence O. Dupuy, Jr., the defendant herein, be and the same is hereby granted."

upon the ostensible grounds that the trial court ordered a new trial on damages only.

10. Whether the action of the Court of Appeals in limiting the remand only to the issue of the quantum of damages was proper in view of the finding of the trial court that the jury verdict for plaintiff (Respondent) in the amount of $905,000.00 shocked the conscience of the court and was the result of passion and prejudice, and in view of the fact that issues of the value of the stock sold are so closely intertwined with issues pertaining to liability that to limit the new trial on remand would deprive Relator of his constitutional rights to due process and fair trial under the Fifth Amendment of the United States Constitution.

STATUTORY PROVISIONS INVOLVED

Section 10(b), of the Securities and Exchange Act of 1934, as amended, 15 U.S.C. Section 78j(b) (1970) provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails . . .
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5, provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails . . .
>
> "(1) To employ any device, scheme or artifice to defraud,
>
> "(2) To make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> "(3) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,
>
> "in connection with the purchase or sale of any security."

STATEMENT OF THE CASE

Presented for review and determination are two legal issues, the resolution of which will be of profound and far reaching significance to the vast body of litigation, under Title 15 U.S.C. Section 78j(b) and S.E.C. Rule 10(b)-5, dealing with securities fraud.

The first question concerns that of the degree of diligence which must be exercised by a plaintiff in protection of his own interests. Despite conflicting decisions from nine of ten circuits, this Court has never addressed itself to this issue.

The second question concerns the sufficiency of "recklessness" to satisfy the "scienter" requirement in actions under Securities Exchange Act Section 10(b) and S.E.C. Rule 10b-5. Determination of this issue was specifically reserved by this Court in *Ernst & Ernst v. Hochfelder,* 96 S.Ct. 1375 at N. 12, p. 1381. A third question concerns the propriety of remanding this case for re-trial on a limited issue of damages only. The factual setting in this case not only presents these legal issues in sharp delineation, but also dramatically illustrates the stark injustice inherent in permitting recovery by one who has shown such monumental disinterest in his own investment by admittedly, utterly and completely failing to investigate the condition of the Corporation of which he was the president and a director. The conduct of Respondent-plaintiff in this case evidenced only an iron-willed determination to sell his shares.

Milton Dupuy, respondent (sometimes hereinafter referred to as "Milton"), filed a complaint against his brother Clarence Dupuy, (sometimes hereinafter referred to as "Clarence"), under Section 10(b), of the Securities Exchange Act of 1934, as amended, 15 U.S. §17j(b) (1970), and S.E.C. Rule 10b-5, 17 C.F.R. 240.10b-5 (1976), on September 7, 1973. He claimed to have been defrauded in connection with the purchase by Clarence of Milton's stock in Lori Corporation, a closely held family corporation, owned 47% by each brother and 6% by their mother, Mrs. Florence Dupuy.

They each lived in different apartments in the same apartment complex. The corporation had been formed in November, 1971, for the purpose of building a hotel in the New Orleans French Quarter. Each brother at that time paid $1880.00 for his stock. Milton made no further cash investment. At all pertinent times, Milton was allegedly President of the corporation and a member of the Board of Directors.

The transfer of the stock from Milton to Clarence and execution of the transfer document was on August 29, 1972. The essence of the complaint was an alleged wrongful withholding by Clarence of information concerning the execution on July 21, 1972, of a partnership agreement by him with one William Monteleone, the contribution by Monteleone of $600,000.00, cash as a limited partner to be used in construction of the proposed hotel and the assignment by Clarence to the partnership of a real estate lease in the name of the corporation, all on the same date of July 31, 1972.

Clarence, the Relator, defended on the grounds that the transfer of stock on August 29th, was pursuant to an oral agreement between the two brothers almost two months prior to the partnership agreement in the early part of June, 1972, confected in the apartment of their mother and in the presence of their mother upon the insistence of Milton, the Respondent, and that Milton knew of Clarence's negotiations with Monteleone and the imminent completion of the partnership as he had been told of it repeatedly, but wanted, and insisted, on withdrawing completely from the hotel venture. Clarence further defended on

the ground that the amount paid for the stock was fair value at the time of the transfer considering that construction had not yet begun, that many risks remained to be faced, and that each brother would be required to personally sign a $5,000,000.00, note for the construction loan and for the permanent financing, which endorsement Milton feared to execute.

The case was tried before a jury and resulted in a verdict in favor of complainant in the sum of $905,000.00. A motion for directed verdict, the ruling on which had been deferred by the court, was re-urged post trial as a motion for judgment notwithstanding the verdict and was granted on the specified ground that there was ". . . no evidence from which a finder of facts might have inferred any diligence on the part of the plaintiff." In so ruling, the trial judge relied upon the latest pronouncements of the Fifth Circuit Court of Appeals in *Johnson v. Wiggs*, 443 F.2d 803 (1971), and *Clement A. Evans & Co. v. McAlpine*, 434 F.2d 100 (1971), to the effect that the plaintiff must show that he had not ". . . ready access to the information involved . . . ," or that he was ". . . a reasonable investor exercising due care in the light of all facts . . . ." In addition, the court granted a conditional new trial under the provisions of Rule 50(c)(1) Federal Rules of Civil Procedure on the basis that the verdict was contrary to the great weight of the evidence and that the amount of the verdict under the circumstances was "shocking to the conscience" and the result of prejudice and passion.

In order to properly understand the ruling of the trial court, an acquaintance with the basic facts of this case, as adduced at trial, complex though they may be, is necessary.

Facts Adduced At Trial

When Lori Corporation was formed in November 1971, a moratorium had been declared by the City Council upon construction of hotels in the French Quarter and this hotel was to be the last permitted. However, to the knowledge of both brothers, construction would have to be substantially commenced within six months of the date of the construction permit, which was obtained January 31, 1972.

The sole asset of the corporation was the lease on the ground upon which the contemplated hotel would be built. This lease obligated the corporation to pay rent of $50,000.00, per year. Both brothers worked together to arrange necessary financing and construction plans until the end of March, 1972.

Together they obtained an $85,000 loan from the Bank of New Orleans to use for initial expenses. They dealt through Mr. Lawrence Merrigan, President of the bank, who required that the note be personally endorsed by Clarence (Relator) and Milton (Respondent). As of the date of the trial in February, 1975, the note was still unpaid.

In their attempts to secure permanent financing, the brothers dealt with Mr. J. H. Harris of Harris Mortgage Company, who, in turn, was endeavoring to obtain the commitment of Colwell Mortgage Corporation for a permanent loan in excess of $5,000,000.00.

The architect who was preparing the plans for the proposed hotel was August Perez, President of the largest architectural firm in Louisiana. He worked primarily with Milton, the Respondent.

The construction financing was to be obtained through the Bank of New Orleans, and Mr. Merrigan testified to having met a number of times with both brothers about this proposed $5,000,000.00 loan.

Milton maintained an office in the same suite where his brother practiced law. The secretary to the two brothers was Miss Claudette Walker who was privy to many of the conversations between the two brothers.

There did not seem to have been any serious problems between the two brothers until late March, 1972. On or about March 27th, Mr. Harris called Clarence and Milton into his office and informed them that the application for permanent financing could not be submitted to the Board of Directors of Colwell Mortgage "until they brought in someone with stronger financial strength." Both Clarence and Milton were quite dejected after receiving the news from Harris about Colwell.

Within the next few days the two brothers visited both Lawrence Merrigan, the banker, and August Perez, the architect, and met again with Mr. J. H. Harris, the mortgage broker. All three men testified to the respective conversations that occurred.[1]

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[1] Note 10, of the Fifth Circuit opinion, (App. p. 22a), which attempts to denigrate the importance of this testimony, misses the point entirely. The fact that Milton was still in the venture and did not state an intention to go out of it during the meeting with these

All three men, Harris, Merrigan and Perez, testified that the name of William Monteleone was brought up in a very positive manner as a prospective partner for the corporation in the hotel venture. Harris testified that if the brothers did get Monteleone that he, Harris, could get them a commitment from Colwell Mortgage. Perez recalled having specifically mentioned the tremendous experience that Monteleone had in the hotel business (he is the owner of a major New Orleans hotel), and Merrigan was equally as enthusiastic, mentioning to the brothers that, since Monteleone was a client of the Bank of New Orleans, he knew of Monteleone's financial strength.

Perez also testified that both brothers assured him that they would personally be responsible for architectural fees already incurred in an amount of over $123,000.00, in the event that the project failed.

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men alters not to the slightest degree the fact that he was told and knew specifically that William Monteleone was to be brought into the venture to comply with the requirement of obtaining someone with "stronger financial strength." It is stated at the end of Note 10, by the Fifth Circuit Decision that "in other words, Harris says Monteleone's name was mentioned on March 30, as a potential partner for both Milton and Clarence, not for Clarence alone." This is exactly correct. August Perez, the architect, also testified that both Milton and Clarence told him about bringing in Monteleone as a partner. Although, as is stated in Note 10, Merrigan was hazy on the time of his meeting with both Clarence and Milton, there can be no doubt whatever but that the conversation concerning Monteleone was in the presence of both brothers and that it could not have occurred until after receipt of the bad news from Harris on about March 27th. Harris, Merrigan and Perez all testified, in essence, that Clarence stated in the presence of Milton at each respective meeting that he intended to bring William Monteleone into the venture as a partner and Harris further testified that it was calculated that Monteleone would be obligated to contribute $600,000.00, cash.

Miss Claudette Walker, the secretary of the two brothers, testified that throughout the early months of 1972, Clarence repeatedly told Milton that he would like not to have to bring anyone else in the venture, but that if the brothers did not get the loan from Colwell Mortgage that he, Clarence, intended to ask Billy Monteleone to go in with them.

The split between the two brothers came at the very end of March or early April, 1972. According to Clarence, it occurred because Milton claimed that they were getting in too deep, that they should quit the hotel venture and go into something else, that there was too much risk involved and that they both stood to lose everything. Clarence disagreed. Milton claimed that the split came because Clarence refused to permit Milton to continue to draw $1150.00 per month management fee from certain partnership properties. This fee had been drawn by Milton, who was not employed, for living expenses though, in fact, he did not manage these partnership properties (which were not related to the hotel venture) and had not managed them for a number of years.

Through April and May, there was virtually no contact between the two brothers except demands delivered by Milton to Clarence through their mother that Clarence buy Milton's shares of stock in Lori Corporation. According to testimony of the mother of the two boys, the three of them met in the apartment of the mother in early June, 1972, and upon Milton's vehement insistence, Clarence agreed to pay Milton $45,000.00, for his stock. Clarence advised Milton that he would have to borrow funds to do it and that he would expect to pay him within about two months. According to the mother, Mrs. Florence Dupuy, Milton told her that Clarence was going in with William Monteleone but that he, Milton, did not care who Clarence went in with and, further, that Clarence would have to pay the $85,000.00, note alone as he, Milton, was getting out.

All of the above testimony, that of Lawrence Merrigan, President of the Bank of New Orleans, of August Perez, President of Perez and Associates Architectural Firm, of J. H. Harris, President of Harris Mortgage Corporation, of Miss Claudette Walker, the secretary to the two brothers, and the testimony of Mrs. Florence Dupuy, the mother of the two brothers, was controverted by Milton, who claimed that, with one minor exception, he never heard the name William Monteleone mentioned in connection with the hotel venture, that he never entered into an agreement with Clarence to sell his stock, and that he never promised Perez that he would be personally responsible for his fee. Milton also testified that he never expressed any reluctance to sign the Five Million Dollar construction loan and the note for permanent financing in like amount. Messrs. Harris and Merrigan testified to the contrary. Merrigan specifically recalled that he told Milton that if Milton was reluctant to sign a construction loan, that the bank would be "very, very reluctant" to make the loan.

After early June, the only record of communication between the two brothers is a series of three letters from Milton to Clarence dated June 11, June 25, and July 9, 1972, respectively, each demanding in the most abrasive terms that Clarence buy Milton's stock immediately and for cash. He accused Clarence of lying to him, of trying to "con" him about offering to buy his shares of Lori Corporation. The letters accused Clarence of trying to steal Milton's various properties. Said Milton, "I want my share of *all* properties in the partnership and in the corporations and I want my share promptly." The letter of July 9th, stated that unless Milton got prompt satisfaction, he would, ". . . have the lawyers to work you over good and properly and they will be well paid to do this." He accuses Clarence of various acts of unethical, immoral and criminal conduct, including theft from his own mother. He states: "You will buy me out or either all the properties will have to go up for sale and you will no doubt wind up in federal prison." The letter concludes with this paragraph:

> "Should you still want to continue to steal on my half of all the properties, I am sure the matter will end up in Court promptly and at that time, I will summon the District Director of the Internal Revenue Bureau to send a representative to his office to listen to my testimony. I will also summon the newspaper and television stations and I am sure they, too, will find what I have to say very interesting and revealing. The District Attorney's office will also be notified and I feel they will be there."

At trial, Milton testified that he had a trusting relationship with Clarence at this time, that his letters were indicative that he acted "how brothers should" act to each other and that he had no reason to question him or to inquire as to the progress of the hotel project from Monteleone, Merrigan, Harris, Perez or from his brother.

Clarence was proceeding alone with his rather tenuous negotiations with the bank, Colwell Mortgage Company, and other parties with whom both brothers had previously dealt together. On behalf of the corporation and in light of the fact that Clarence had agreed to buy Milton's shares and that Milton no longer considered himself connected with the corporation but had only to collect his money, Clarence signed the resolution necessary to complete the transaction with Monteleone on July 31, 1972, which involved a partnership agreement between Lori Corporation & Associates (40%), Clarence Dupuy, individually (40%), and the Monteleone Interest (20%). This partnership, Lori Corporation & Associate, was the assignee of the long term lease, per assignment executed by Clarence on behalf of Lori Corporation. Monteleone contributed $600,000.00, in cash, which was escrowed and earmarked for construction. This was not paid to Clarence as a purchase of a portion of his interest in the project. Clarence received nothing. At this time, there was as yet no construction contract signed, no permanent financing completed, and a very real risk that construction of the hotel would not be allowed by the City, or that a suit would be filed to stop construction because of the passage of the deadline for its commencement.

The sale of the stock from Milton to Clarence was executed August 29, 1972. According to Milton, it was completed following demands by Milton that Clarence

buy his stock but motivated by statements of Clarence that the hotel project was "going down hill." According to Clarence, the sale was executed upon the urging of Milton as a result of continuous pressure exerted by Milton through their mother who relayed the messages with the urgent plea that Clarence "pay Milton out of the hotel" as Milton was constantly demanding.

Although Milton claimed that he really would like to have stayed in the hotel venture and that he got out only because he was misled by Clarence, he admitted at the trial that throughout the summer of 1972, he

1) *never* inquired as to the status of negotiations by Clarence with Colwell Mortgage Corporation, Harris Mortgage Corporation, or any other mortgage corporation or lending institution concerning permanent financing for the hotel;

2) *never* inquired concerning the status of an $85,000.00, note which had been executed by Lori Corporation in late 1971, as seed money for the hotel and *personally* endorsed by both Clarence and Milton;

3) *never* inquired as to whether the rent of $1500.00 (the rental required during the first twenty-four months of the lease) per month on the property leased in the French Quarter, site of the future hotel, was being paid, or if so, how it was being paid or whether the lease still existed;

4) *never* inquired, despite his knowledge of the deadline of construction, as to the status of attempts by Clarence to find a partner who would contribute the

necessary cash. Without such a partner, to Milton's own knowledge, the project was doomed;

5) *never* inquired as to the status of obligations to August Perez in excess of $100,000.00 for plans for the hotel. It must be stated that Milton claimed that nothing was owed Perez, that Perez had agreed to do the plans for nothing in the event the project fell through. Perez, however, had testified that both Milton and Clarence had agreed to assume personal responsibility for these plans;

6) *never* asked to see any corporate records or resolutions prepared in connection with the partnership and transfer of the lease to the partnership; and

7) *never* inquired of anyone else as to any of these matters despite the ready availability of all information to him from:

a) Lawrence Merrigan, President of the Bank of New Orleans, who stated that at any time through August 29th, he would have given full information;

b) J. H. Harris, who stated that at all times he would have given Milton full information upon simple inquiry; and

c) August Perez who stated he would have been glad to furnish Milton with full particulars upon inquiry.

Respondent at the trial and on appeal placed every emphasis, as did the Fifth Circuit decision, on the fact

that Milton suffered from a kidney disease diagnosed in 1965, as uncurable glomeruler nephritis, as a justification for his failure to inquire as to any of these matters concerning Lori Corporation. There is no doubt that Milton was sick, and no doubt that this kidney ailment merits sympathy, but the statement of the Fifth Circuit (App. p. 50a), that the disease "had worsened considerably by 1972" is without support in the record. By Milton's own testimony, he was quite able to use the telephone. He worked full-time from mid-May to mid-August 1972, and prior to mid-May, he was home using the telephone and writing letters, again according to his own testimony. By the testimony of his own Doctor, there was no change in his condition observed in examinations of January 14, 1972, April 14, and August 29, 1972. These were the only visits made by Milton to his physician that year. He was no better or worse in April and August than he had been when he was working with Clarence on the hotel project in January.

Trial Court's Action

The jury returned a verdict on special interrogatories in favor of Milton, Respondent, on all issues and against Clarence, Relator, in the sum of $905,000.00. It must be noted here that Respondent had paid a total of $1880.00, for his stock nine months previously, worked for the corporation for approximately three and one-half months, made no additional capital contributions, and, in addition to substantial cash consideration, received upon sale, was relieved of his personal obligations on the $85,000.00 note to the bank. At the time of sale, there was no interim or construction or permanent financing, there was a real risk that the building permit had expired, and the only asset of the corporation was a lease on vacant land coupled with a rental obligation of $50,000.00/year.

Motions filed during the trial by Relator for a directed verdict were urged after trial as a motion for judgment notwithstanding the verdict in favor of Relator, Clarence, dismissing the petition, of Milton, Respondent. In addition, Clarence filed a motion for a conditional new trial under the provisions of Rule 50(c)(1) of the Federal Rules of Civil Procedure on grounds that the verdict was contrary to the great weight of the evidence and that the size of the verdict was excessive.

The District Court granted Judgment N.O.V. with the observation that there was no evidence that Milton had exercised due diligence as required by law and that the jury verdict with respect to diligence was not only contrary to the great weight of the evidence, but against "... all of the evidence that I have been able to discern." He further continued (App. p. 6a):

> "I will state for the record, although this is not directly before me, that if it were not for the Court's ability to make this finding in the fashion that I have, I would feel compelled to grant a new trial, because I feel under all of the circumstances of the case, the size of the verdict which shocked the Court's conscience and also be contrary to the weight."

He further stated that the verdict was a result of "compassion." Shortly thereafter, it was brought to the attention of the Court by Respondent, with the concurrence of Relator, that under the provisions of Rule 50(c)(1) of the Federal Rules of Civil Procedure, the Court should rule on the motion for a new trial despite the fact that he had granted a judgment notwithstanding the verdict in favor of the mover.

The Trial Court entered no written reasons for the judgment N.O.V.; the Court's oral reasons were issued from the bench. A transcript of these oral reasons are set forth in the Appendix herein. In response to this motion by respondent, the Court entered a judgment which "... for reasons orally pronounced by the Court", ordered that the conditional motion for a new trial, "... be and it is hereby granted."

Circuit Court's Action

On appeal to the Fifth Circuit, as can be seen by reference to the decision of May 9, 1977, appended hereto, the Court of Appeals did not address itself to the question of whether the trial judge had decided correctly or incorrectly in accordance with the law of due diligence as it then existed. Instead, the Fifth Circuit imposed new and far less stringent standards upon the plaintiff and ruled that, as a matter of law, a reasonable jury might have found that the plaintiff was not reckless in his behavior; that is, that there was sufficient evidence to support a holding that "... Milton did not have knowledge of the risk of Clarence's forming the partnership with Monteleone and obtaining financing for the hotel." The Appellate Court ruled that "... there was also sufficient evidence to support a jury conclusion that Milton did not act in intentional disregard of whether Clarence had taken this course of action." (App. p. 43a)

In addition, the Court ruled that the trial court did not abuse its discretion in granting the conditional new trial but read the language of the trial court as granting the new trial on quantum only and remanded the case solely for a hearing as to the amount of damages. The ruling with regard to liability is, hence, a final decision by the Fifth Circuit.

Certiorari is sought to review this holding of the Fifth Circuit concerning liability, particularly with reference to due diligence and the charge of the Court concerning scienter on the part of defendant, and to further review the propriety, in any event, of remanding the case for trial on the issue on damages only.

REASONS FOR GRANTING WRIT

Conflict Among The Circuits ("Diligence")

Since *J.I. Case Co. v. Borak*, 377 U.S. 426, 84 S.Ct. 1555 (1964), affirmed the right of Federal Courts to grant relief to private parties under 15 U.S.C. Section 78j(b), the various Circuit Courts of Appeal have fashioned rules that determine the availability of this remedy. Four elements to this cause of action have evolved: scienter on the part of defendant; materiality of misrepresentation or omission; reliance by the plaintiff; and due diligence on the part of the plaintiff.

Substantial harmony concerning the first three elements has been reached among the Circuits either through separate but parallel lines of decision or through pronouncements by this Court, such as in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 Sup.Ct. 1375, pertaining to scienter, or *Affiliated Ute Citizens v. U.S.*, 406 U.S. 128, 92 S.Ct. 1456 (1972), pertaining to reliance with respect to fraud by omission.

Only the fourth element, diligence on the part of plaintiff, is now characterized by hopeless confusion and contradiction among the circuit. The precedents are disarray and have not been unified through any decision by this Court. A diligent search fails to reveal a single instance wherein this Court has spoken on the subject. A review of the case law, circuit by circuit, reflects the result of this absence and the need for an authoritative pronouncement, which only this Court can make.

First Circuit

Rogen v. Illikon Corp., 361 F.2d 260 (1966), does not speak explicitly in terms of diligence, but sanctioned the analysis of the facts to determine if reliance by plaintiff on misrepresentations was reasonable or justifiable, quoting with approval *Royal Air Properties, Inc. v. Smith*, 333 F.2d 568 (9th Cir. 1964), supporting the view that plaintiff may succeed although he was ". . . exceedingly gullible in that he was overtrusting," in view of the fact that ". . . his professional activities are wholly divorced from the world of business."

Second Circuit

In *Metro-Goldwyn Mayer, Inc. v. Ross*, 509 F. 2d 930 (1975), the Court relied upon the contract between the parties as well as Rule 10b-5, in holding that representation by the parties were paramount to any investigation in behalf of the parties and that the affirmative duty to disclose prevailed despite knowledge of some facts on the part of plaintiff contradictory to the representations relied upon. However, in *Frigitemp Corp. v. Financial Dynamics Fund*, 524 F.2d 275 (1975), it was held that the defendants were under no duty to disclose that which could have been determined by the plaintiff, and the court quoted 2 A.Bromberg Securities Law: Fraud — S.E.C. Rule 10(b)-5, to the effect that "there is wide spread agreement among the courts that constructive knowledge of truth or omitted information will bar plaintiff from 10(b)-5, recovery."

Third Circuit

In *Straub v. Vaisman & Co., Inc.*, 540 F.2d 591 (1976), the court stated:

> "Where the defendant acts intentionally, the line should be drawn between the extremes of making the plaintiff's lack of diligence, regardless of degree, a complete bar or at the other limit — completely irrelevant. (citing cases) The latter option fails to encourage investor caution and, under the former view, Rule 10(b)-5, would provide less assistance to the trusting or gullible than does the common law."

The Third Circuit stated that the obligation of due care must be a "flexible one, dependent upon the circumstances of each case. We require only that the plaintiff acts reasonably."

Included among the factors determining whether plaintiff has acted reasonably are "fiduciary relationship, opportunity to detect the fraud, sophistication of the plaintiff, the existence of long standing business or personal relationships, and access to the relevant information . . . ."

In *Rochez Bros., Inc. v. Rhoades*, 491 F.2d 402 (1974), the Third Circuit had stated that:

> "The cases generally hold that before an insider may claim reliance on a material misrepresentation or nondisclosure, he must fulfill a duty of due care in seeking to ascertain for himself the facts relevant to a transaction."

In *Rochez Bros., Inc.*, the Court found that there was no such opportunity as the facts were not discoverable by plaintiff.

Fourth Circuit

No cases dealing directly with the subject of diligence in 10(b)-5 cases have been identified from the Fourth Circuit, and we pretermit for the moment discussion of the jurisprudence emanating from the Fifth Circuit.

Sixth Circuit

There is no duty to disclose information in this circuit to one who reasonably should already be aware of it. *Securities and Exchange Commission v. Coffey*, 493 F.2d 1304 (1974). This would negate a duty to direct the seller's attention to all routine data that is readily available to the plaintiff. *Arber v. Essex Wire Corp.*, 490 F.2d 414 (1974). In *Arber* it was held that the information in question was readily available to plaintiffs who, "although aware of its existence and availability, were simply uninterested."

Seventh Circuit

In *Kohler v. Kohler Co.*, 319 F.2d 634 (1963), it was held that the defendant purchaser was entitled to take into account the actual and normal business acumen of the seller. It was stated that:

> "Here, the company could fairly deal with a person who had had many years of intimate acquaintance with the affairs of the corporation, who were closely related to many principals of the corporation, who had intrinsic sources of sound business advice, and who, himself, was promoting a speedy sale, in a manner that might not be fair if plaintiff had been a novice to stock transactions or the corporation's activities."

However, this does not apply to cases of intentional fraud; and "contributory negligence" would be no bar to an action under the statute based on fraud. *Carroll v. First Nat'l Bank of Lincolnwood,* 413 F.2d 353 (1969).

Eighth Circuit

Myzel v. Fields, 386 F.2d 718 (1967), agreed with the Seventh Circuit that there is ". . . no duty to disclose information to one who reasonably should already be aware of it." Nor is there any necessity for one insider to "search out details for another insider in the same

sense that such a duty might exist toward others less informed." The test was stated to be whether the nondisclosed fact was equally known "or available" to both parties.

City National Bank of Fort Smith Arkansas v. Vanderboom, 422 F.2d 221 (1970), quoted with approval "Negligent Misrepresentations Under Rule 10(b)-5," 32 University of Chicago Law Review 824, 841-2 (1965):

> "Not only should the plaintiff have to prove that he relied on the defendant's statements, but he must convince the trier of fact that his reliance was reasonable under all the circumstances at the time. In this way recovery would be denied to those who, because of their 'business sophistication' acumen, or ready access to the information involved, could reasonably be expected to exercise a higher degree of care and investigation in their dealing."

The Court also quoted with approval language from the same article proposing that an ". . . objective standard of a reasonable investor exercising due care in light of all facts effectively imposes a duty of reasonable investigation, thereby limiting the class of investors who will be protected under 10(b)-5(2) to conscientious buyers and sellers in good faith."

Ninth Circuit

White v. Abrams, 495 F.2d 724 (1974), requires that the duty of defendant to disclose depend on the sophistication, status and information of the plaintiff, as well as on the nature of the relationship between the parties and the amount of reliance that the plaintiff places in the defendant.

Tenth Circuit

Holdsworth v. Strong, 545 F.2d 687 (1976), is except for the instant case, one of the few to address itself to the diligence issue since the decision of this Court in *Ernst & Ernst*. In *Holdsworth v. Strong*, like the instant case, it was held that "if contributory fault of the plaintiff is to cancel out wanton or intentional fraud, it ought to be gross conduct somewhat comparable to that of defendant." The Court in *Holdsworth v. Strong* stated that the plaintiff, considering the decision of this court in *Ernst* is not ". . . duty bound to investigate the truth or falsity of an intentional misrepresentation unless the misrepresentation is patently false." However the court emphasized that the plaintiff may not reasonably or justifiably rely on a misrepresentation where a falsity is palpable.

Fifth Circuit

We turn, then, to an examination of the jurisprudence from the Fifth Circuit from which this case arises. Unlike the decision in *Holdsworth v. Strong, supra.*, the *Dupuy* case was not the initial encounter of the Fifth Circuit with the diligence issue. The fact is that the decision of this Court in *Ernst & Ernst, supra*, effected little, if any, change in the scienter requirements that had previously been imposed by the Fifth Circuit. Unless and until this Court ultimately holds that recklessness is not sufficient to satisfy the scienter requirement, it is difficult to discern any change in the law of the Fifth Circuit concerning scienter required by decisions of this Court. The Fifth Circuit has always been of the view that actions under Rule 10(b)-5, required proof of something less than intent, but more than simple negligence. *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579 (1974); *Azalea Meats, Inc. v. Muscat*, 386 F.2d 579 (1974); *Hudak v. Economic Research Analyst, Inc.*, 499 F.2d 996 (1974); and *Sargent v. Genesco, Inc.*, 492 F.2d 750 (1974).

Yet, despite the fact that simple negligence has never been sufficient as a basis for a Rule 10(b)-5, action in the Fifth Circuit, that circuit embraced the diligence requirement not only of the Eighth Circuit, but also of the Seventh Circuit, which required proof of negligence only on the part of the defendant. In *Clement A. Evans & Co. v. McAlpine*, 434 F.2d 100 (1970), the Fifth Circuit quoted with approval *City National Bank of Fort Smith v. Vanderboom, supra*, of the Eighth Circuit:

> "Not only does the plaintiff have to prove that he relied on the defendant's statements, but he must convince the trier of fact that his reliance was reasonable under all the circumstances at the time."

The Fifth Circuit went even further. In expressing approval of the above the following was stated in *Clement A. Evans & Co., supra:*

> "We are of the view that plaintiff's duty above espoused is not altered merely because the misrepresentations are alleged to be inten-

tional rather than negligent. Surely plaintiff would not contend that a purchaser or seller could justifiably rely on a fraudulent misrepresentation, no matter how willfully and intentionally made, if the misrepresentation would tax even the most credulous mind.

> "We are cognizant, of course, that our views have a limiting effect upon the class of investors who may recover in a Rule 10(b)-5 action for damages. But, such limitation is consistent with the views expressed in the decisions of this and other circuits."

Further, in *Johnson v. Wiggs,* 443 F.2d 803 (1971), the Fifth Circuit stated its interpretation of the "insider rule" to limit Rule 10(b)-5, actions to the protection of "outsiders" against "insiders" who deal in securities through the utilization of information which is and can be known only to them because of their position as insiders. The Fifth Circuit cited and followed *S.E.C. v. Texas Gulf Sulphur,* 401 F.2d 833 (2d Cir. 1968).

Nonetheless, the appeal of the ruling of the District Court in the instant case was the occasion for a review and overhaul by the Fifth Circuit of its own rulings with respect to diligence; and the decision for which review is sought herein promulgates a completely new standard by which to measure the conduct of the plaintiff.

The Court of Appeal, in order to conclude that a reasonable jury could have found that Plaintiff exercised due care and thus to overrule the judgment n.o.v. despite its acknowledgement that Plaintiff did nothing to investigate, reaches out to establish a new standard for "due diligence". The Court of Appeal seizes upon the pronouncement of this Court in *Ernst & Ernst* requiring "scienter" by *defendant,* to establish an equally strict standard for Plaintiff's "due care". *Ernst & Ernst* does not address itself to "due care" in any shape, form or manner; but, since *Ernst & Ernst* restricts a 10(b) action to intentional or (possibly) reckless conduct, the Court of Appeals holds that "due diligence" means nothing more than absence of intentional or reckless conduct by plaintiff.

Such reasoning overlooks the fact that the "scienter" requirement for defendant is based on the very language of 10(b), whereas "due care" is a requirement developed by jurisprudence. As an affirmative defense, the duty of due care would deny recovery not because there has been no violation of the rule, and not because the plaintiff has not been injured by the defendant's conduct, but because as a policy matter, the law should not protect, through implied remedies, those who do not take minimal steps to protect themselves, Bromberg, "Plaintiff's Due Care Under Rule 10b-5, "70 NWU L Rev. 561, 596. Just as Congress did not intend to subject merely negligent conduct of a defendant to an action under 10(b), Congress did not intend to relieve a plaintiff from availing himself of all information that an investigation "would have disclosed." *Bromberg, supra,* p. 598; *Still v. Smith,* 473 F.2d 1205 (5th Cir., 1973); *Shappirio v. Goldberg,* 192 U.S. 232, 241-42; *Arber v. Essex Wire Corp.,* 490 F.2d 414 (6th Cir., 1974) where the Court said:

> "When the means of knowledge are open and at hand or furnished to the purchaser or his agent and no effort is made to prevent the party from using them — he will not be heard to say he has been deceived to his injury by the misrepresentations of the vendor."

The case law dealing with "due care" imposes greater duties on plaintiff in face to face transactions involving stock in a closely held corporation than it imposes in the case of an open market situation. *Bird v. Ferry*, 497 F.2d 112, 114 (5th Cir., 1974). Such flexible standards involves a much sounder rationale than the Fifth Circuit Court of Appeal's mechanical rule of equating plaintiff's standard of care with that of defendant.

When the U.S. Court of Appeals for the Ninth Circuit in the case of *Blue Chip Stamps v. Manor Drug Stores*, 492 F.2d 136, reversed the decision of the district judge, 339 F.Supp. 35, and remanded, this Court granted a writ of certiorari and held that the Birnbaum rule bars respondent from maintaining this suit. In so doing this Honorable Court reasoned that:

> ". . . virtually all lower federal courts facing the issue in the hundreds of reported cases presenting this question over the past quarter century have reaffirmed Birnbaum's conclusion that the plaintiff class for purposes of Section 10(b) and rule 10b-5, Private Damage Actions is limited to purchasers and sellers of securities."

This Court further reasoned as follows:

> "The long standing acceptance by the courts coupled with Congress' failure to reject Birnbaum's reasonable interpretation of the wording of Section 10(b), wording which is directed towards injuries suffered "in connection with the purchase or sale" of securities, argues significantly in favor of acceptance of the Birnbaum rule by this court."

Applying the reasoning of *Blue Chip Stamps* with regard to the Birnbaum rule to the "Due Diligence" rule, it is respectfully submitted that a writ should be granted because of:

(a) The long standing judicial acceptance of the rule requiring due diligence;

(b) Congress' failure to reject the interpretation of Section 10(b) as requiring due diligence, over a period of many years;

(c) Policy considerations predominantly favoring adherence to the due diligence; and

(d) the "recognition that litigation under rule 10b-5 presents a danger of voraciousness different in degree and in kind from that which accompanies litigation in general."

The "Due Diligence", "Reasonable Diligence" or "Due Care" concepts, by the very significance of those terms cannot be restricted to "intentional or reckless behavior." Black's Dictionary, Fourth Edition, p. 544 defines "Due Diligence" as:

> "Such a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case. Perry v. Cedar Falls, 98 Iowa 315, 54 N.W. 225."

In *Hirsch v. Dupont*, 553 F.2d 750 (1977), the court states:

> "Securities laws were not enacted to protect sophisticated businessmen from their own errors of judgment, and said investors must, if they wish to recover under federal law, investigate information available to them with care and prudence expected from people blessed with full access to information."
>
> "Sorilledde's failure to pursue this line of investigation suggested either that, despite appearances, the knowledge he would have discovered was immaterial, Titan Group v. Faggan, 513 F.2d 234 (2nd Cir., 1974), cert. denied 423 U.S. 840, or that Gariboldi failed to exercise due diligence to obtain important information, see Rochez Bros. Inc. v. Rhoades, 491 F.2d 402, 409-10 (2nd Cir., 1974), cert. denied 425 U.S. 993."

The Court of Appeal by imposing the "scienter" requirement upon the duty of due care utterly and completely misconceives the very nature of the same. Section 10(b) is designed to encourage responsible behavior in the securities markets. This imposes upon

the plaintiff the duty to use reasonably obtainable information, a duty that, conceptually, is not limited to "intentional or reckless" behavior.

Only through an analysis of the application of these newly promulgated judicially-created rules by the Fifth Circuit to the facts of this case can the meaning of the rules become clear. In essence, the grossest behavior imaginable on the part of an investor is deemed not to be disqualifying. The Fifth Circuit pays lip-service to retention of the "methodology" of *McAlpine*, (App. p. 29a); but the application of that so-called methodology in this case reveals that the requirement of diligence, whether termed negligence or recklessness under the Court's new rules, has been torn assunder.

The Fifth Circuit recognized some obvious problems with the plaintiff's case arising out of his almost bizarre lack of interest in anything but sale of his stock, *now and for cash*, for several months prior to the consummation of the transfer on August 29th. The Court stated (App. p. 47a):

> "Two factors indicate that Milton intentionally sold his stock in disregard of all chances for success. First, the parties agree that the sale occurred without any independent investigation by Milton into the affairs of Lori. Although he knew Merrigan, Perez, and Harris, he did not discuss the sale with them."

A comment is necessary. Not only did Milton not discuss the sale with them; he discussed nothing at all with them. He made not the slightest inquiry into the progress of the hotel, irrespective of any stock sale. As the owner of forty-seven percent of the stock, as president and a member of the Board of Directors, one might have found it curious, not only that Milton did not discuss with them a prospective sale of his stock, but also that he did not once, over a period of almost five months after his rift with his brother, and almost three months after his verbal agreement to sell his stock to his brother, see fit to question the banker, mortgage broker, or architect at all; or to ask whether a possible partner had been obtained; whether necessary financing had been obtained or if prospects for financing were imminent; whether the rent was being paid on the vacant ground; where the money was coming from to pay the rent; whether the $85,000 note, which he had personally signed, had been paid; whether Mr. Perez was still working on the plan; or whether there were indeed any prospects for a hotel or not.

The Fifth Circuit continues:

> "Second, Milton initiated the sale negotiations and exerted pressure for a quick agreement."

He did indeed. He told Clarence, in writing, in the most abrasive possible manner: that he wanted cash now; that he no longer wanted to stay in any venture in which Clarence was participating; that Clarence was a thief who was trying to steal from him; and that, unless Clarence bought all of Milton's investments, Clarence was going to wind up in jail.

According to the testimony of Milton's mother, she was continually urging Clarence to keep his promise to buy Milton's stock. She went to Clarence every time that Milton came to her wanting to know when Clarence was going to buy his stock, and apparently

Milton must have come to her many times indeed for she was in Clarence's apartment practically every morning during late July and August urging Clarence to complete the sale.

The Fifth Circuit itself saw fit to note as a significant fact in *Johnson v. Wiggs, supra,* that the sale was ". . . not as a result of Wiggs' efforts to purchase but by the acceptance of an offer of Johnson to sell." See also *Kohler v. Kohler, supra.*

To reach its conclusion that Milton did not act recklessly, it was necessary to conclude (App. 43a) that there was sufficient evidence in the record to support a holding that Milton did not have knowledge of the risk of Clarence's forming the partnership with Monteleone and obtaining financing and that he, Milton, did not act in intentional disregard whether Clarence had taken this course of action.

Ignoring the fact that the corporation had been formed solely for the purpose of building a hotel and that it was uncontroverted that there could be no financing until some partner was obtained, the Fifth Circuit grudgingly acknowledged (App. p. 44a):

> "Harris testified that he discussed with Clarence and Milton the possibility of tapping Monteleone as a source of financing. Merrigan and Perez also recalled meetings at which the brothers mentioned Monteleone as an investor. And their mother stated that Milton himself informed her of the partnership."

The Fifth Circuit then justifies the action of the jury in ignoring all of this testimony by citing a case whose very rationale it, in truth, disregards:

> "Nevertheless, the Jury, as the fact finder, assesses the credibility of these witnesses and resolves this factual dispute. *Boeing Co. v. Shipman*, (5th Cir. 1969), 411 F.2d 365, 375. If the jury believed Milton's testimony, then it could have reasonably concluded that Milton knew nothing of the risk of the partnership having been created." (App. p. 44a).

Indeed. For what did Milton think he was being paid any money at all for his stock, or for what reason did he think he was being released on an $85,000 note, if Clarence was not pushing ahead to do the very things he had said he was going to do and for which the corporation had been originally formed?

Even more remarkable, however, is that the Fifth Circuit, without comment on the action of the trial judge in finding that the verdict was against the overwhelming weight of the evidence, finds that a reasonable jury could have disregarded the testimony of the bank president, the mortgage broker, the architect, and the mother of the two boys, to say nothing of the testimony of the secretary of the two brothers, which is not mentioned in the decision, and to accept in lieu thereof the self-serving testimony of Milton Dupuy. *Boeing Co. v. Shipman*, cited by the Fifth Circuit in support of this methodology, stated, however, that "a mere scintilla of evidence is insufficient to present a question for the jury" and held further:

> "On motions for directed verdict and for judgment notwithstanding the verdict the Court should consider all of the evidence — not just that evidence which supports the non-mover's case — but in the light and with all reasonable inferences most favorable to the party opposed to the motion. If the facts and inferences point so strongly and overwhelmingly in favor of one party that the Court believes that reasonable men could not arrive at a contrary verdict, granting of the motions is proper."

However, one need not make any in depth inquiry into the standards to be applied in determining the question of judgment notwithstanding the verdict; the quantity of evidence need not be examined. The uncontested and uncontroverted facts were such that something other than extortive demands by Milton that Clarence buy his stock must be called for if there is any requirement of diligence whatsoever, whether it be freedom from negligence or freedom from recklessness that must be proved.

Two other factors must be mentioned in connection with the decision of the Fifth Circuit in its application of its newly formulated rules pertaining to diligence as applied to this case.

FIRST: The Fifth Circuit was obviously impressed with the fact of Milton's unfortunate illness. There is no doubt that the affliction itself is deserving of sympathy, but is not a justifiable basis for a verdict in this case although it obviously influenced the thinking of both the jury and the Fifth Circuit. The Appellate Court stated (App. p. 50a) that ". . . the time that Milton could devote to any investigation was limited by his search for employment and later by the substantial amount of traveling required by the new job." The "investigation" would have involved nothing more than one simple telephone call to any of the parties mentioned above: Harris, the mortgage broker; Perez, the architect; or Merrigan, the banker, all of with whom he had previous extensive business dealings. He never even placed a single question to his brother concerning the progress of the hotel. All he asked for was money for his stock. Nowhere in the jurisprudence is there any support for such an exception to the rule of diligence. Milton's illness has no bearing on the issue. There was no testimony about extensive traveling, only testimony about occasional trips, none which would have prohibited a simple inquiry into the status of the hotel.

SECONDLY: The Fifth Circuit obviously believed, as did the jury, that Milton had sold his stock for a small fraction of its true worth, thus not only corroborating his claim that he knew nothing of the progress of the hotel venture, but also creating a picture of a gross injustice that cried out for rectification. The Fifth Circuit stated (App. p. 24a):

> "At that time there could be no doubt that Milton's stock was enormously valuable."

The appellate court ignored, as did the jury, the testimony of defendant's expert who testified that the plaintiff's stock was worth a maximum of $25,000.00 as of August 29, 1972. The expertise of this witness, Mr. Carmi Gamoran, included involvement in the financial planning of approximately 30 hotels throughout the country, including the Hyatt Hotels in Los Angeles, Houston and Sarasota, Florida. He is a certified public accountant with many years experience with a large New York based firm. Mr. Gamoran used the income projection method of determining the value of plaintiff's stock, the only truly valid basis for such a determination.

The huge figures that were tossed about by plaintiff's experts in order to persuade the jury were based upon the totally fallacious method of equating the investment of $600,000 by Mr. Monteleone who obtained a 20% interest as a *limited partner*, as though it were a sale of 20% interest in the venture by Mr. Clarence Dupuy for which Clarence received and pocketed the $600,000. The $600,000 was actually Monteleone's contribution to the partnership, which was created and it was placed in escrow and earmarked for construction. He had no further responsibility.

Monteleone was not obliged to sign a promissory note nor to invest extra capital, nor did he have any responsibility for planning or construction of the hotel or for operation thereafter. He was further allowed the first $500,000 in tax write-offs by the partnership agreement. He was additionally limited to a maximum $100,000.00 profit after a period of five years. Clarence Dupuy had the sole responsibility to personally sign the $5,000,000.00 note, to oversee and supervise the planning and construction and the operation of the hotel. Yet the Appellate Tribunal, no less than a lay jury, treated this $600,000.00 as though it were a purchase of something Clarence owned and set a market value on it. On the date of the sale, August 29, 1972, the object of the lease was an empty lot. There was no construction, nor even a construction contract. Although permanent financing was now more likely, there was as yet no commitment. There was the prospect that construction of the hotel would be barred through the lapse of time or that a suit would be filed to stop construction once commenced. Yet plaintiff's experts treated the matter as though the hotel was standing as a completed structure with every stick of furniture in place and already producing the revenues that the optimistic brochures projected. The reasoning is contrary to *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 92 S.Ct. 1456 (1972), in that it treats the ultimate worth of the underlying assets as a measure of damages. The trial judge recognized the stark invalidity of such reasoning and remarked that such testimony was far from the mark of true market value as he understood it, and later described the jury verdict based on such testimony as shocking to the conscience and the result of prejudice and passion. Although the matter has been remanded by the Fifth Circuit for retrial on the issue of damages, the decision of the Fifth Circuit and the issues that are here presented to this Honorable Court, cannot be fully understood without some reference to the aspect of the case involving quantum.

The injustice in this case is not to the Respondent. The injustice consists in awarding any sum in addition to the substantial consideration received to a plaintiff who insisted on and succeed in selling his stock at a large profit (he invested only $1,880 just five months previous to the oral agreement, and eight months prior to the consummated sale). Declining to risk his own substantial fortune, he precipitously withdrew from the hotel venture. Having refused to face the risks and delays, having turned his back on his obligations to the corporation and a deaf ear to all that was transpiring, he now seeks profits of a magnitude that will bankrupt his brother, or may not accrue to his brother for a generation if ever. There can be nothing in Section 10(b) or Rule 10(b)-5 to countenance such a result.

Need to Settle Important Questions of Federal Law ("Recklessness")

The issues presented for review not only affect the litigants to this case, but also affect the broad spectrum of securities transactions throughout the nation. The policy underlying the recent decisions of this Court in *Ernst & Ernst v. Hochfelder, supra*, and in *Blue Chip Stamps v. Manor Drug Stores*, 421 U. S. 723, 95 S. Ct. 1917, 44 L. Ed. 2d 539 (1975), expressing concern "that the inexorable broadening of the class of plaintiffs who may sue in this area of the law will ultimately do more harm than good", emphasizes the need of this Court to settle the important questions of Federal law regarding the scienter and due diligence standards at issue herein.

The Circuit Court in this case has held that the holding of this Court in *Ernst & Ernst* requiring scienter on the part of the defendant in order to impose Rule 10b-5 liability mandates a relaxation of the plaintiff's due diligence standard, which relaxation, if allowed, will invite all investors to throw caution to the wind, secure in the notion that reasonable diligence is not required of them. In light of the above policy underlying *Ernst & Ernst* however, this Court should render an authoritative decision for the benefit of all the Circuits.

The Circuit Court has additionally disregarded the question whether recklessness on the part of the defendant suffices for the imposition of liability under S.E.C. Rule 10b-5, which question was specifically reserved from the holding of this Court in *Ernst &*

Ernst. This important question of Federal law should be authoritatively determined by this Court.

In connection with the sufficiency of recklessness to impose liability under S.E.C. Rule 10b-5, it is respectfully submitted that the trial Court erred in its charge to the jury on "proscribed conduct" where it instructed:'

> "*Third:* To complete his proof that the defendant acted in an unlawful manner, the plaintiff must show that the misrepresentations and/or omissions were done knowingly, or that such acts were done recklessly." (Emphasis supplied)

The Court further instructed:

> "An act is done recklessly when done in conscious disregard of, or with indifference to, the risks that the plaintiff would be misled. If a person makes a representation without knowing whether it is true or not, or makes it without regard to its truth or falsity or to its possible consequences, he may be found to have made the representation recklessly."

The first interrogatory propounded to the jury was the following:

> "Do you find that in regard to the sale of stock by Milton E. Dupuy to Clarence O. Dupuy, Jr., that the defendant, Clarence O. Dupuy, knowingly or *recklessly* misrepresented and/or failed to disclose any material facts to the plaintiff, Milton E. Dupuy?" (Emphasis supplied)

The defense objected to the use of the term "reckless" in the instruction.

Subsequent to the trial, on March 30, 1976, this Court decided *Ernst & Ernst v. Hochfelder, supra:*

> "We granted certiorari to resolve the question whether a private cause of action for damages will lie under Section 10(b) and Rule 10(b)-5 in the absence of any allegation of 'scienter' — *intent to deceive, manipulate, or defraud.* 421 U.S. 909 (1975). We conclude that it will not and therefore we reverse." (Emphasis supplied)

This Court held that "... an intent to deceive, manipulate or defraud is required for civil liability under Section 10(b) and Rule 10(b)-5 ..." (Note 7, p. 1380).

In Note 12 of that decision, Your Honors stated:

> "In certain areas of the law, recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act. We need not address here the question whether, in some circumstances, reckless behavior is sufficient for civil liability under Section 10(b) and Rule 10(b)-5."

This question, the sufficiency of "recklessness" is not only squarely presented by the jury instructions of the Court and the formulation of the interrogatory above quoted, but also is squarely presented by the factual setting in which the case arises. Further, it is closely entwined with the issue of the degree of diligence, if any, that is to be required of plaintiff. The decisions of the Fifth Circuit in the instant case and of the Tenth Circuit in *Holdsworth v. Strong, supra*, are based upon such comparative analysis and relative fault. It would be difficult to imagine a more uniquely appropriate setting for a determination of the question of: 1) whether recklessness suffices to supply the necessary scienter and 2) if so, the appropriate definition of such recklessness.

Additionally, in this case, such rules should be applied in light and in consideration of the behavior of the plaintiff, and any standards applicable to his obligation of reasonable investigation, if any such obligation be found by this Court to exist.

The charge of the District Court in this case would appear to be deficient in several particulars even should this Court ultimately determine that recklessness, or at least one of the various definitions of it, suffices. It is noted with regard to these instructions that:

1) "Recklessness" was not placed before the jury in the framework of a form of intent.

2) "Indifference to the risks that the plaintiff would be misled" or "without knowing whether it is true or not" are not correct explanations of "recklessness" as opposed to negligence, particularly in light of the requirements of *Ernst & Ernst*.

If recklessness be deemed sufficient, this Court should formulate the appropriate standards to be applied. The definition advanced by the District Judge is most certainly inadequate and the matter should be remanded for trial before a jury properly instructed.

Undoubtedly, the standard to be applied to the conduct of the plaintiff in a 10(b) case will ultimately be fashioned by this Court with due regard to the minimum standards required of the defendant.

Should this Court agree with Relator that the unique factual setting and the legal issues in this case warrant review by this Court, it would appear that the alleged misconduct on the part of Relator, which at the very most could be characterized as recklessness, should be measured against that of Respondent, which can hardly be characterized as anything short of reckless.

The Fifth Circuit refused to address itself to the scienter question raised by Clarence, Relator-Appellee. The Fifth Circuit decision states in Note 34, page 3032 (App. p. 56a):

> "As part of his argument for a new trial, the appellee challenges the scienter instruction of the trial court. Because the appellee did not cross-appeal, however, this issue is not properly before the Court and is not included in our remand for a new trial. The District Court ordered a new trial only on damages. . . ."

In this, the Court of Appeal was patently incorrect. Defendant did not cross-appeal because there was nothing to cross-appeal from. The trial Court granted judgment notwithstanding the verdict in favor of Clarence, the relator herein, and further granted him a new trial. The new trial was *not* limited to the issue of damages. That misreading of the trial court's judgment by the appellate court will be the subject of discussion below. For the moment, however, suffice it to say that by its very terms, the judgment granting Judgment N.O.V. in favor of Relator and the conditional new trial under Rule 50(c)(1) granted to defendant everything he had requested. It has never been the rule that one could appeal from the *reasons* for judgment. The judgment which is the subject of this dispute states in pertinent part. (App. p. 8a):

> "IN THE ALTERNATIVE, AS REQUIRED BY RULE 50(c)(1) OF THE FEDERAL RULES OF CIVIL PROCEDURE, AND FOR THE REASONS ORALLY ASSIGNED BY THIS COURT,
>
> IT IS FURTHER ORDERED, ADJUDGED AND DECREED THAT THE ALTERNATIVE MOTION FOR A NEW TRIAL MADE BY CLARENCE O. DUPUY, THE DEFENDANT HEREIN, BE AND IS HEREBY GRANTED."

Without taking a cross-appeal, however, the appellee is entitled to urge in support of the judgment below in his favor any matter appearing of record, which may constitute *additional* grounds for affording the relief requested and for the appellate court to consider in affirming the grant of a new trial. *U.S. v. American Railway Express Co.*, 265 U.S. 425 at 435, 44 Sup.Ct. 560 at 564, 68 L.Ed. 1087; *Commercial National Bank in Shreveport v. Parsons*, 144 F.2d 231 (5th Cir. 1944).

The issue was properly preserved in the only way in which, under the existing law and rules of court, it could be preserved for further review. That the Court of Appeals erred in finding that the district court limited the grant of a re-trial to damages only will be further discussed in connection with the issue raised below concerning the propriety of limiting the remand of the case to damages only. But the question of the trial court's charge on scienter was squarely and properly before the Fifth Circuit and is properly presented to this Court.

Departure By The Circuit Court From The Accepted And Usual Course Of Judicial Proceedings To Such An Extent As To Call For An Exercise Of This Court's Power Of Supervision ("Limited Remand")

It is respectfully submitted that the Circuit Court's limited remand on the issue of the quantum of damages was improper in that it misread the trial court's judgments, and oral reasons thereon, granting a new trial on all issues, and in that it completely disregarded the trial court's holding that the jury verdict shocked the conscience of the court and was the result of prejudice and passion and completely disregarded the fact that where, as here, the issues as to liability and damages are so interwoven, a limited remand works an injustice to Relator so great as to deprive him of his constitutional rights of due process and to a fair trial.

The written judgment of the lower court granting the new trial is set forth above and is appended hereto (App. p. 7a) and, as can be seen by simple reference thereto, is without limitation as to issue.

The oral remarks of the trial judge in open Court afford no basis for concluding that the trial judge intended in any way to limit the scope of the new trial. It is doubtful that the *reasons* assigned by the lower court for the new trial were limited to questions of damages. Having found in his grant of Judgment N.O.V. that the verdict was ". . . contrary to all of the evidence that I have been able to discern," the district judge must certainly have found that it was contrary to the overwhelming weight of the evidence so as to justify the conditional new trial. Be that as it may, it is apparent that the Court of Appeals has confused two aspects of the lower Court's ruling:

1) The *reasons* for which the new trial was granted; and

2) The *scope* of the new trial.

There was nothing in the lower court's oral statement, or in the written judgment, which would have permitted any reasonable inference that the Court intended to limit the *scope* of the new trial, which it alternatively granted. The appellant, Respondent herein, himself made no such inference and no such issue was ever briefed or argued below.

The district court's oral remarks were made in open court after granting the Judgment N.O.V. in favor of defendant Clarence. The Court stated (App. p. 6a):

> "I will state for the record, although this was not directly before me, that if it were not for the Court's ability to make this finding in the fashion that I have, I would feel compelled to grant a new trial because I feel under all the circumstances of this case, the size of the verdict which shocked the Court's conscience and also be contrary to the weight . . . the court concludes, under these circumstances, that the jury must have reached this verdict only on the basis of compassion."

As explained in Note 32 of the decision of the Fifth Circuit (App. p. 52a), the Appellate Court read those remarks as limiting the remand to the issue of damages. Even if the Court correctly reads the remarks as limiting the reasons for the remand to the question of damages, the conclusion that the remand itself is for a trial only on damages is untenable. Such a retrial would be contrary to establish jurisprudence under the circumstances of this case and contrary to the dictates of this Court in *Gasoline Products v. Champlin Refining Co.*, 293 U.S. 494, 51 Sup.Ct. 513, 75 L.Ed. 1188:

> "Where the practice permits a partial new trial, it may not properly be resorted to unless it appears that the issue to be retried is so distinct and separable from the others that a trial of it alone may be had without injustice (Citing Cases). Here the question of damages on the counterclaim is so interwoven with that of liability that the former cannot be submitted to the jury independently of the latter without confusion and uncertainty, which would amount to a denial of a fair trial . . . . there should be a new trial of all issues raised by the counterclaim."

If, as the trial court concluded, the verdict on damages was shocking to the conscience and infected with passion and prejudice, what assurance of fairness in its resolution of the complex issues of liability exists? In such instances a complete new trial is required. *Minneapolis, St. Paul & S.S.M.R. Co. v. Moquin,* 283 U.S. 520, 51 S.Ct. 501, 75 L.Ed. 1243.

The decisions among the circuits have been remarkably uniform in their reluctance to retry on the limited issue of damages in similar circumstances. *Howell v. Marnpegso Compagnia Naviera,* 536 F.2d 1032 (5th Cir. 1976); *Ford Motor Co. v. Mahone,* 205 F.2d 267 (4th Cir. 1953); *Edwards v. Sears, Roebuck & Co.,* 512 F.2d 276 (5th Cir. 1975); *Grimm v. Calif. Spray-Chemical Corp.,* 264 F.2d 145 (9th Cir. 1959).

In *Grimm, supra,* the Appellate Court upheld the action of the trial court in granting a re-trial on all issues even though a re-trial on damages only had been requested:

> "Here the issues are interwoven to the extent that a retrial of the damage issue alone would be grossly unfair to the Appellee. . . . .
>
> "In these circumstances, the judge was doubtlessly persuaded that he must either deny the relief asked by the appellant or order a new trial on the issues of both liability and of damages. In this unusual posture of affairs we are satisfied that the Court did not exceed its jurisdiction in granting a new trial on both issues."

It would be difficult to imagine a case in which issues of liability and damages are more closely interwoven than in the case before this Court. It is virtually impossible to try the damage issue without producing practically all of the evidence bearing on the matter of liability.

Virtually every factor affecting liability is a factor tending to negate the claim of relator that he was deceived as to the value of the stock, or that any omission of Relator was material in nature. A determination on the materiality of any alleged misrepresentations or omissions is inextricably affected by the determination regarding whether Plaintiff-Appellant received fair value upon sale of his stock.

CONCLUSION

This case presents legal issues of crucial importance and wide-spread interest to courts, commentators, attorneys and investors. The issues are presented in a framework that calls for thorough analysis and careful formulation of complex and important rules of conduct. Above all, the writ should be granted, so that this high tribunal may review and correct the radical, innovative and unjustified departure by the Court of Appeals from a well established rule of law, by imposing limitations on the "due diligence" concept which all but writes the same out of Section 10(b) actions, and run contra to the philosophy and reasoning espoused by this Court in *Ernst & Ernst* and *Blue Chips, supra.* And finally, concededly of more importance to Relator than to the Court, grant of the writ will enable this Court to determine whether, as Relator believes the gross injustice in this case is not any fraud perpetrated on Respondent. The injustice is the gross misuse of Section 10(b) to obtain huge undeserved profits after having a deliberate choice to opt out for immediate cash, as correctly perceived by the trial judge.

We respectfully pray that this Court grant a Writ of Certiorari ordering that the record be forwarded to this Court for review and that, after due consideration, the judgment notwithstanding the verdict of the trial court dismissing plaintiff's case be reinstated. Alternatively, we pray that the entire case be remanded for new trial on *all* issues with appropriate instructions concerning the law of scienter and of the degree of diligence required of plaintiff.

Respectfully submitted,

MILTON E. BRENER
1304 F.N.B.C. Building
New Orleans, La. 70112
Telephone 504/581-9322

ARTHUR L. BALLIN
1121 Carondelet Building
New Orleans, Louisiana 70130
Telephone 504/523-2155

ATTORNEYS FOR RELATOR

CERTIFICATE OF SERVICE

I hereby certify that three copies of the foregoing Petition for Writ of Certiorari have been personally served on:

C. Ellis Henican, Jr., Esq.
Suite 4440
One Shell Square
New Orleans, Louisiana 70130

this ___ day of July, 1977.

I further certify that all parties required to be served have been served.

MILTON E. BRENER

APPENDICES

A. Trial Court Motion For Judgment Notwithstanding The Verdict And For New Trial, March 11, 1976.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

MILTON E. DUPUY

Civil Action
versus No. 73-2370
Section "I"

CLARENCE O. DUPUY, JR.

MOTION FOR JUDGMENT NOTWITHSTANDING THE VERDICT AND FOR A NEW TRIAL

Pursuant to Civil Procedure Rules 50 and 59, defendant, CLARENCE O. DUPUY, JR., hereby moves this Court to set aside the verdict of March 3, 1976, and the judgment of March 5th rendered thereon and to enter judgment in his favor dismissing plaintiff's suit notwithstanding the said verdict and further moves that a new trial be granted. The verdict is contrary to the law and the evidence in the following particulars:

1.

There is no evidence in the record of damages suffered by the defendant by any legally acceptable criteria.

2.

There is no evidence that the plaintiff exercised due diligence as required by law.

3.

There is no evidence to justify suspension of the running of the statute of limitations beyond the date of the transaction complained of, August 29, 1972.

4.

The weight of the evidence is that the plaintiff did not rely on misrepresentations or omissions of the defendant, but demanded and insisted that defendant buy his stock for cash without regard to success or failure of the hotel venture.

5.

There is no evidence of any misrepresentation and no evidence that any failure to disclose information was knowing or reckless.

WHEREFORE, defendant prays that the verdict of March 3, 1976, and the judgment of this Court of March 5, 1976, be set aside and that this Court render judgment notwithstanding the verdict dismissing the plaintiff's suit at his cost and that a new trial be granted.

GARON, BRENER & McNEELY
1304 First National Bank of
Commerce Building
New Orleans, Louisiana 70112
581-9322

/s/ MILTON E. BRENER
MILTON E. BRENER
/s/ ARTHUR BALLIN
ARTHUR BALLIN
Suite 1121
Carondelet Building
226 Carondelet Street
New Orleans, Louisiana 70130

B. Transcript of Trial Judge's Oral Reasons For Judgment Issued From Bench June 9, 1976.

THE COURT:

Gentlemen, I have, I guess I've studied, worried about this case as much as anything I ever had, because I realize it means a great deal to the parties because of the result by the jury.

After deliberation, I have concluded that I have no alternative, under the applicable standard, but to grant a Judgment Notwithstanding The Verdict on the basis that the Plaintiff did not exercise due diligence, as required by the law and as the Court instructed the jury and that the jury's finding to the contrary, was not only against the great weight of the evidence, but against all of the evidence that I have been able to discern.

You have a situation where the evidence is clear that the Plaintiff, at least, until May, of 1972, is fully conversant and very active in the promotion of a hotel venture that he had issued financial statements showing his value as being almost half a million dollars, that he took active part in the negotiations with bankers, architects, financial consultants, seeking to obtain financing, long-term financing and that he was

President of the corporation and Director of the corporation.

Subsequent to May, of 1972, there is a completely divergent version of the story as to what happened between the Plaintiff and the Defendant. To put it bluntly, either the Plaintiff or, the Defendant is lying.

Obviously, the jury made its decision on issues of credibility. The jury is entitled to great weight.

I don't, however, need to get to issues of credibility in reaching the decision that I have reached in this matter, because taking all of the evidence in the case that is, by the Plaintiff, by witnesses produced by the Plaintiff and by the Defendant, there is no evidence from which a finder of fact might have inferred any diligence on the part of the Plaintiff.

Plaintiff has introduced letters that he wrote to his brother, the Defendant, in which he, in very abrasive, crude language, accused him of every type of conceivable fraud and the desire to do the Plaintiff out of his interest in all of their ventures, apartment buildings, that they owned jointly, business properties. There was, to put it bluntly, and to put it mildly, an utter distrust by the Plaintiff in the Defendant.

Yet, regardless of which version of facts around the sale of this stock is accepted, there was absolutely no effort on the part of Plaintiff to verify or, take any steps to verify any information that might have been given him by the Defendant when such information could have been available over the telephone.

We have testimony by the banker, Mr. Merrigan, by Mr. Harris, the mortgage broker, by the architect, that they would have informed the Plaintiff. He had dealt

with them before, a telephone call would easily have disclosed the true situation.

There is no reason to believe that even if the Defendant were involved in some effort to defraud the Plaintiff, there is absolutely no evidence to indicate that these people, reputable men in the community, would have participated.

In short, for the Plaintiff feeling as he did, as expressed by the evidence which he introduced, by his complete inability to put any trust in his brother, the Defendant, in this Court's opinion, cannot justify his actions and in effect, putting his head in the sand or, attempting to have the finder believe that he can put his head in the sand and make no inquiries concerning the stock of the corporation of which he, if you accept his version, had no reason to believe that he was anything other than the President and Director, until the consummation of the transaction.

Now, the Plaintiff has argued totally that the Court should infer due diligence from actions on the part of the Defendant, that the finder of fact might have inferred it from actions on the part of the Defendant.

I think this is circuitous logic, it is certainly true that the degree of artifice which the Defendant in this case might have used, might bear upon the standard of due diligence required of the Plaintiff.

But, in this case, the Plaintiff exercised no due diligence in a situation where, by his own testimony and by his own evidence, he should have exercised the greatest of diligence for his own protection.

Therefore, I have no hesitation and no difficulty, after viewing all of the evidence and particularly after having counsel for the Plaintiff verify the rectitude of my conclusions concerning the evidence, the actual direct and circumstantial evidence, in granting a

Judgment Notwithstanding The Verdict purely on the basis of failure of the Plaintiff to prove that his reliance was reasonable under the circumstances at the time and that the jury's findings is completely against and contrary to the great weight of the evidence.

If it were not for this fact, the Court would be faced with a much more difficult decision and that is, whether to grant a new trial.

I will state for the record, although this is not directly before me, that if it were not for the Court's ability to make this finding in the fashion that I have, I would feel compelled to grant a new trial, because I feel under all of the circumstances of the case, the size of the verdict which shocked the Court's conscience and also be contrary to the weight. I would grant a new trial rather than a remittitur, because I feel that it would be unfair to both sides for the Court to substitute its own judgment.

You have here a situation where the jury heard evidence for almost two weeks, heard very complex instructions as to the law, went out and deliberated for less than an hour-and-a-half, including sending the Court a question.

The Court concludes, under these circumstances, that the jury must have reached its verdict only on the basis of compassion and not a considered verdict, as required.

Thank you very much.

MR. BRENER:

Your Honor, may I ask one point of clarification?

Under the Federal Rules, as I understand it, when the Court rules on a judgment N.O.V., I don't know whether Your Honor has overruled a motion for new trial, considered it moot or, what. But, as I understand, the Court should also either rule on the new trial or, hold it in abeyance in the event, which we hope doesn't happen, the —

THE COURT:

Well, I will hold it in abeyance.

I have stated my reasons for the benefit of the parties.

MR. BRENER:

Okay, I understand.

THE COURT:

I am informed, gentlemen, by the Clerk, that there is also a motion by the Plaintiff to amend the verdict, which I presume is moot, in light of the Court's ruling.

C. Trial Court's Judgment Notwithstanding The Verdict And For New Trial, June 18, 1976.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

MILTON E. DUPUY

versus

CLARENCE O. DUPUY, JR.

Civil Action
No. 73-2370
Section "I"

JUDGMENT

The Court having previously granted the motion of defendant for Judgment Notwithstanding the Verdict;

accordingly for reasons orally pronounced by the Court,

IT IS ORDERED, ADJUDGED AND DECREED that there be judgment in favor of defendant, Clarence O. Dupuy, Jr., and against plaintiff, Milton E. Dupuy, dismissing said plaintiff's suit, at plaintiff's costs.

In the alternative as required by Rule 50(c)(1) of the Federal Rules of Civil Procedure, and for the reasons orally assigned by this Court,

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the alternative motion for a new trial made by Clarence O. Dupuy, the defendant herein, be and is hereby GRANTED.

Dated at New Orleans, Louisiana, this ___ day of June, 1976.

/s/ NELSON B. JONES
NELSON B. JONES,
CLERK

APPROVED AS TO FORM:
/s/ [ILLEGIBLE]
UNITED STATES DISTRICT
JUDGE

D. Judgment Of Court Of Appeals, May 9, 1977.

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 76-2667

D. C. Docket No. CA 73-2370 "I"

MILTON E. DUPUY,
Plaintiff-Appellant,

versus

CLARENCE O. DUPUY, JR.,
Defendant-Appellee.

Appeal from the United States District Court for the Eastern District of Louisiana

Before JONES, WISDOM and GODBOLD, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Eastern District of Louisiana, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed in part and reversed in part; and that this cause be, and the same is hereby remanded to the said District Court in accordance with the opinion of this Court;

It is further ordered that defendant-appellee pay to plaintiff-appellant, the costs on appeal to be taxed by the Clerk of this Court.

May 9, 1977

Issued as Mandate:

E. Opinion of Court of Appeals, May 9, 1977

Milton E. DUPUY, Plaintiff-Appellant,

v.

Clarence O. DUPUY, JR., Defendant-Appellee.

No. 76-2667.

United States Court of Appeals,
Fifth Circuit.

May 9, 1977.

Appeal from the United States District Court for the Eastern District of Louisiana.

Before JONES, WISDOM and GODBOLD, Circuit Judges.

WISDOM, Circuit Judge:

In this brother-against-brother case, a purchaser of stock, to depress the price, misrepresented and failed to disclose material facts regarding the value of the stock. The question presented is whether the seller of the stock will be denied recovery against the purchaser under Securities and Exchange Commission Rule 10b-5[1] because the seller, who could have ferreted out the facts, failed to do so until after the sale.

The case turns on the degree of diligence required of the plaintiff, Milton Dupuy, under Rule 10b-5 when the defendant, his brother Clarence, intentionally committed acts of fraud that significantly affected the plaintiff's decision to sell the stock at a price considerably below its value. This is primarily a question for the jury to decide. Here, on interrogatories submitted to the jury, the jury decided that the plaintiff had "exercised due diligence for his protection in connection with [the] sale of the stock"[2], and awarded Milton damages of $905,000.

---

[1] 17 C.F.R. 240.10b-5 (1976) states in part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

The Rule is promulgated under section 10-b of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970):

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

The trial judge granted the defendant's motion for a judgment notwithstanding the verdict. He held that there was "no evidence from which a finder of fact might have inferred any diligence on the part of the plaintiff".[3] Alternatively, the trial judge stated that "if it were not for the Court's ability to make this finding

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[2] This is language of the district court's fourth interrogatory. The court's question and the jury's answers included the following:

> 1. Do you find that in connection with, and prior to the sale of stock by Milton E. Dupuy to Clarence O. Dupuy, Jr., that the defendant, Clarence O. Dupuy, either knowingly or recklessly misrepresented or knowingly or recklessly failed to disclose any material fact(s) to the plaintiff, Milton E. Dupuy?
> Answer "Yes" or "No"
> Answer: Yes X No ___
> 2. Did Milton E. Dupuy rely on the misrepresentations of the defendant or would he have attached importance to the information withheld from him in connection with and prior to the sale of the stock?
> Answer: Yes X No ___
> 4. Do you find that Milton E. Dupuy exercised "due diligence" for his protection in connection with this sale of stock?
> Answer: Yes X No ___
> 5. On what date do you find Milton E. Dupuy discovered, or should have discovered, through the exercise of reasonable diligence, the misrepresentations or omissions referred to in Interrogatory No. 1?
> Answer by checking one:
> Before September 7, 1972
> On or after September 7, 1972 X
> 6. What amount do you feel will adequately compensate the plaintiff for the damages he has sustained?
> Answer by means of a numerical figure.
> Answer: $905,000

[3] Fed.R.Civ.P. 50(b).

in the fashion I have, I would feel compelled to grant a new trial, because I feel under all the circumstances of the case, the size of the verdict . . . shocks the Court's conscience and also [is] contrary to the weight [of the evidence]".[4]

We reverse the judgment n. o. v., but remand the case for a new trial on damages.[5]

I.

The Facts

Clarence and Milton Dupuy were raised in poverty in a poor section of New Orleans. They worked as children and as youths and always on a share and share alike basis. Until the dispute arose that generated this litigation the two brothers worked harmoniously for many years on real estate ventures. By 1971 they had accumulated certain valuable properties held by Les Freres Corporation, Argonne Corporation, Dupuy and Dupuy, a partnership, and Dupuy Construction Company, a partnership. The stock and the partnerships were divided equally between Clarence and Milton. Clarence was the older brother and dominated their personal relationships. He was an attorney, a successful politician, and an elected member of the New Orleans City Council. Milton did not finish college, but acquired firsthand knowledge of the construction business and real estate development. At one time he was appointed and served as President of the Orleans Parish Levee Board.

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[4] Fed.R.Civ.P. 50(c). The court added:

> . . . I would grant a new trial rather than a remittur, because I feel that it would be unfair to both sides for the Court to substitute its own judgment.

[5] This is the second appeal of this case. Shortly after the suit was filed, Clarence moved for summary judgment on the ground of lack of federal jurisdiction. The district court granted the motion. *Dupuy v. Dupuy*, E.D.La.1974, 375 F.Supp. 730. This Court reversed and remanded for trial, *Dupuy v. Dupuy*, 5 Cir. 1975, 511 F.2d 641.

In late 1971 the Dupuys organized the Lori Corporation to acquire a valuable long-term lease on land bounded by Toulouse, Burgundy, Rampart, and St. Peter streets in the City of New Orleans. This property is within but on the edge of the French Quarter. The value of the land was enhanced when, prior to the Dupuys' acquisition of the lease, the City Council of New Orleans declared a moratorium on construction of hotels in the French Quarter, but excepted from the ban the premises just described.

To form Lori Corporation, each brother contributed $1,880 to the enterprise and received 47 percent of the company's stock.[6] Milton was president, Clarence Secretary-treasurer, and Mrs. Dupuy, their mother, vice-president. During 1971 and early 1972 Milton supervised the day-to-day development of this venture.[7] He signed the lease with the landowner, met frequently with the architect, August Perez, and assembled statistics for the necessary financing. He and Clarence met with the president of the Bank of

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[6] Their mother, Mrs. Florence Dupuy, received the remaining six percent of the stock.

[7] The brothers managed Lori as they had managed several other properties owned jointly, including apartments and a parking lot. Milton supervised the development of the projects and managed them after construction. Clarence provided legal services and financing.

New Orleans, Lawrence Merrigan, and a mortgage banker, J. H. Harris, (representing Colwell Mortgage Trust), to discuss financing the project. As compensation for these duties and his management of other jointly held properties, Milton received a monthly fee of $1,150.

At Harris's suggestion, Milton obtained an appraisal from a Mr. John D. Bird, in whom Colwell had confidence. Bird valued the project initially at $7,340,000 and the market value of the lease at $986,500,000. Because of changes in the plans, he reduced these figures respectively to $7,100,000 and $962,330,000.

All went well until March 30, 1972, when Clarence abruptly cut off Milton's management fee. Clarence had always controlled the checkbook. Clarence says that Milton turned his back on the project. At the time, however, Milton's monthly fees were his sole source of income; he had no substantial savings; Milton had serious kidney trouble causing increasing medical expenses; and he was supporting his present wife and child and his former wife and children. He could not borrow on his interest in the Les Freres and Argonne corporations, because he had no means of paying the debt. Milton asked Clarence to buy his interest, but Clarence offered him only a note. Milton's financial crisis forced him to find other employment. He obtained a job with Norman Brothers, real estate developers, but the work required travel to Clearwater, Florida, and to Algiers (across the Mississippi River from New Orleans). After three months, his health was so bad that he had to give up this job. He had worked for Norman Brothers from May 15 to August 18, 1972.

After his management was terminated and having no personal contacts with the development of the Lori property, Milton had to rely on Clarence for information as to what was happening to the financing of the projected hotel. Milton testified that whenever he spoke to Clarence over the telephone Clarence told him that the Lori Hotel "was having a rough time . . . everything is going downhill"; that "it's just practically worthless".

Shortly after Clarence cut off Milton's income, Clarence began negotiations with William Monteleone, owner of a well-known and long-successful French Quarter hotel. Earlier, Clarence and Milton had discussed but had never pursued the possibility of interesting Monteleone in the venture. Milton testified that Monteleone's name came up just once and then as a possible purchaser of some of Milton's stock. The banks and mortgage brokers had conditioned financing of the construction of the Dupuy hotel on the participation of someone having larger financial resources than Clarence and Milton possessed.

Clarence's negotiations with Monteleone and his representatives were extensive. A letter to the New Monteleone Hotel from Arthur L. Ballin, an attorney who represented Monteleone, shows that instead of "everything going downhill", prospects were favorable. As early as April 21, Ballin had a four-hour conference with Monteleone and Clarence to review the "proposition of joint venture and partnership in commendum".[8] On April 24 there was a two-hour conference by Ballin and Clarence to prepare a draft of the partnership. At that time, Monteleone was prepared to put up the necessary financing. On April 28 there was a two-hour conference by Ballin with Clarence and Monteleone, who expressed doubts about the joint venture. These doubts were later dissipated. Ballin talked with Clarence on May 1 and arranged for a meeting the next day. May 2 Ballin met with Clarence. They were in agreement as to the partnership, but Clarence wanted and obtained an option to repurchase Monteleone's interest. May 5 Ballin had several telephone conferences and a meeting with Clarence. On May 8 Ballin again met with Monteleone and Clarence. On that day Monteleone instructed Ballin to prepare papers to complete the transaction. There followed meetings by Ballin with Clarence on May 12,to discuss provisions of the partnership agreement; on May 13, to re-draft the partnership agreement; on May 15, with Monteleone as well as Clarence, to revise the agreement; on May 17, a meeting with Clarence, after Ballin had studied the tax effects of the agreement; on May 19, a long telephone conversation to discuss the tax effects; on May 22, a meeting by Ballin with Clarence and accountants to discuss tax effects of the partnership. June 2 Ballin met with Clarence to review the revised agreement. June 6 Ballin met for three hours with Clarence and accountants to review the revised partnership agreement and tax questions. Finally, on June 7, 1972, Ballin met with Clarence and reviewed the final form of the partnership and Clarence's option. The partnership agreement called for Monteleone to put up, individually, $180,000 in cash, for which he would receive a 6 percent interest, and the New Hotel Monteleone, Inc., to put up $420,000 in cash

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[8] The events referred to in this paragraph are taken from a letter by Arthur J. Ballin to the New Hotel Monteleone, Inc., dated July 6, 1972. (App. 47)

for a 14 percent interest. The Lori Corporation would receive a 40 percent interest, for its lease to the land on which the hotel was to be built. Clarence would receive a 40 percent interest. Thus, for two months before Clarence bought Milton's stock and for one month before the putative directors' meeting approving the partnership with Monteleone, Clarence knew that the Lori stock was worth a small fortune. But not Milton, although he lived in the same apartment complex with Clarence and they shared a patio.

The partnership agreement was executed on July 31, 1972, before Arthur L. Ballin, in his capacity as Notary Public. Clarence Dupuy appeared individually and as Secretary-Treasurer of Lori Corporation. William A. Monteleone appeared individually. The New Hotel Monteleone appeared through its duly authorized Executive President.

On that same day, July 31, 1972, Clarence signed a certificate as Secretary of Lori Corporation certifying as true and correct a resolution, adopted by the Board of Directors of the Corporation, authorizing Clarence to execute on behalf of Lori Corporation the partnership with Clarence Dupuy, William A. Monteleone, and New Hotel Monteleone, under the name of "Lori Corporation and Associate". The contribution of the corporation was to be the assignment of the Lori lease to the partnership. Also, on that same day Clarence certified as true and correct a resolution authorizing an option in favor of Clarence and Lori Corporation, for five years, to repurchase the interests of William A. Monteleone and the New Hotel Monteleone for $700,000.

On cross-examination, Clarence admitted that he had not notified Milton of any meeting of the Board of Directors and that no meeting had been held. Indeed, so he said, no meeting of the Board had ever been held for the Lori Corporation or for any other of their corporations. This loose practice might be understandable when the two brothers had harmonious relations. But a jury would find it hard to understand why it did not put Clarence under the unshakable duty to disclose the facts to Milton, when the effect of the meeting that did not exist was to make effective the partnership with Monteleone resulting in the successful financing of the hotel and the assignment of Lori's sole asset to the partnership.

Because of Monteleone's participation, the partnership received a construction loan of $5,000,000 from Colwell Mortgage Trust. Clarence accepted Colwell's offer on July 25, subject to certain changes. Colwell approved the changes on July 27.

Clarence revealed none of these facts to Milton. Indeed, during the time he was negotiating with Ballin and Monteleone he assured Milton that the development of the hotel had been stalled by a failure to obtain financing. Not knowing of Clarence's bright future for the hotel, never having been informed of the need for a bona fide or non-existent directors' meeting, and hard pressed financially, Milton urged Clarence to buy his stock.

Milton, more and more apprehensive about his investment, wrote letters to Clarence June 19, June 25, and July 9, 1972.[9] These letters clearly show that Milton mistrusted his brother. By that time, however, Clarence had closed his agreement with Monteleone, except for executing final papers. He gave no inkling of this to Milton.

In early June 1972 Clarence sent Milton a statement from G. E. Conroy, their accountant, for $375, and asked him to co-sign a check of Lori Corporation for that amount, payable to Conroy. The statement did not show the nature of the services performed. The record shows that they were to consider the tax aspects of Clarence's proposed transactions with Monteleone. Milton asked for a full report on what Conroy had done to earn the $375. Clarence did not reply to this request.

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[9] After writing letters of June 11 and June 25, Milton sent the third on July 9, a letter that demonstrates that as of that date Milton had no agreement to sell his stock to Clarence:

> Clarence,
>
> I have had plenty of time to review your past actions and it is quite clear and can be proven that you have systematically stolen from me. In addition, you are now trying to steal something that is rightfully mine, my share of all the property.
>
> You have lied and tried to con me about offering to buy my share of the Lori Corporation. . . .
>
> I do not want to be part of any business venture or partnership or corporation arrangement whereby you may have an interest. I want my share of ALL the properties in the partnership and in the corporations and I want my share promptly. . . .
>
> I want only my share that belongs to me and I want it now. And unless I get it I will have the lawyers to work you over good and properly and they will be paid well to do this. . . .
>
> Any offer that you may want to submit you must do so in writing only. . . .

The letter of June 25 states, in part: "You deliberately wanted me out of the corporation and this is the reason you abruptly cut off my income from our partnership and forced me to seek employment elsewhere on a full time basis." Clarence testified that he construed this language as consistent with his having entered into an agreement with Milton on June 22 by which he purchased Milton's stock. A jury could reasonably have reached the opposite conclusion.

The jury could have inferred that a reply would have disclosed to Milton his negotiations with Monteleone.

In August, still thinking that the hotel venture was in deep trouble, Milton agreed to sell his 47 percent interest in Lori for $10,000. On August 29 Milton signed the agreement of sale. He did so without consulting the bankers, the architect, or any lawyers. He explains that he relied on Clarence's representations because, in spite of his mistrust, Clarence was his brother on whom, in spite of everything, he had always relied. Moreover, his kidney disease prevented an independent investigation. His kidney disease, diagnosed in 1965 as incurable glomeruler nephritis, had worsened considerably by 1972. It had forced Milton to quit his job on August 18, at which time, he said, he was flat on his back. The Social Security office set the date of his complete employment disability as April 1972.

Milton argues that the true value of his 47 percent interest in Lori was at least $500,000 and perhaps $1,200,000. On January 28, 1972, Clarence had estimated the value of his 47 percent at $493,250.00. A preconstruction appraisal valued the lease alone at $1,000,000. In February 1972 the equity value of the proposed hotel was estimated at $1,810,000. And the Monteleone transaction appears to have been based on a total value of $3,000,000.

Clarence tells a different story. As noted, he contends that the termination of Milton's income resulted from Milton's voluntary withdrawal from the hotel venture. Discussions with the Bank of New Orleans and the mortgage broker had revealed that both brothers would have to sign the note for the construction loan. According to Clarence, Milton did not want to risk his entire fortune on the hotel; he was insistent that Clarence buy his interest in the project.

Clarence asserts that during the financial meetings with Merrigan and Harris, Milton discussed with them the prospect of a partnership with Monteleone.[10] The topic also arose in a meeting with the architect, Perez, according to both Clarence and Perez. The mother of the men testified that Milton told her in June that Monteleone was to be Clarence's partner. During this conversation, Milton reportedly reaffirmed his desire to sell his interest in the hotel. Clarence testified that not only had Milton reason to believe in the prospect of the Monteleone partnership, but he knew of its actual formation.

The brothers have different versions of the terms of the sale of the Lori stock. According to Clarence, Milton first suggested the sale and frequently pressured him through their mother for a speedy agreement on the terms. Clarence denies any direct contact with Milton except for a June meeting at which they agreed on a price of $45,000, $10,000 to be paid by check and $35,000 to be paid in cash; Clarence was to assume the corporation's note of $85,000 for interim financing. The payment on August 29, 1972, was witnessed by Milton's wife and mother. The mother testified that Clarence carried the cash to Milton's apartment in a large cardboard box. Milton denies both the June meeting and the payment of any cash, a denial corroborated by his wife.

Even though Clarence says that he paid $45,000 for Milton's interest in Lori, he insists that the stock was absolutely worthless at the time and that Milton could not have suffered any damages from the sale. Disregarding the successful financing, he argues that in August Lori owned only a lease that required annual rent payments of $50,000. There was no hotel, no income. Even if the hotel were built, substantial business risks precluded any guarantee of success. And the inherent lack of marketability of close corporation stock detracted further from the value of Milton's investment. Considering that Milton had contributed only $1,880 to the venture in 1971, Clarence argues that $45,000 was more than an adequate return in 1972. Clarence's return consisted of the value of 94 percent of Lori stock plus a 40 percent interest in the partnership.

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[10] Clarence overstates the supportive value of the testimony of Merrigan, Perez, and Harris.

Merrigan said that to say whether Milton was present at the meeting where Monteleone's name came up, he would have to rely on his memory, which he could not do. (Tr. XVII, 23) In fact, he could say only that he felt he may have met with Milton in January or February 1972. (Tr. XVII, 23). Merrigan testified that his appointment book listed only Clarence as having had an appointment on March 27, 1972; that Monteleone's name came up only as a hypothetical possibility. (Tr. XVII, 26).

Perez's testimony is inconsistent with Clarence's basic contention that Milton's salary was cut off because Milton turned his back on the project. Perez testified to a meeting with Clarence and Milton on March 28, 1972, (Tr. XVIII, 6) and it was his recollection that both Clarence and Milton had attended. According to Perez, both Clarence and Milton said on this date that the two brothers were considering the possibility of bringing Monteleone into the hotel project, (Tr. XVIII, 8) and both of them would guarantee Perez's fees (Tr. XVIII, 8). Milton and Clarence told him to keep working. Clearly, Milton was not disheartened about the project at this March 28, 1972 meeting (Tr. XVIII, 19), two days before Milton's monthly fee terminated. About a month later, *Clarence* told Perez Milton was out of the deal. He did not see Milton after March 28, 1972.

Harris did testify that Monteleone's name had come up in a meeting attended by Milton on March 30, 1972. That was the date on which Milton's management fee was terminated. According to Harris, there was no evidence that Milton was withdrawing from the project. The first he heard of that was when Clarence told him so on May 22, 1972. (First Supp. Record, 145) In other words, Harris says Monteleone's name was mentioned on March 30 as a potential partner for both Milton and Clarence, not for Clarence alone. (First Supp. Record, 126)

Summarizing, Clarence bought Milton's 47 percent stock interest on August 29, 1972. A month before, July 31, Monteleone had paid $600,000 for a 20 percent interest in the partnership. By August 29 a $5,000,000 construction loan had been obtained. Two months before, on June 31, Clarence certified a resolution, on its face adopted by the Board of Directors approving the partnership and assignment of Lori's lease. At that time there could be no doubt that Milton's stock was enormously valuable.

Clarence is here represented by Ballin. Ballin, here arguing that on August 29 Milton's 47 percent stock interest was virtually worthless, embraced a transaction in June and July requiring Monteleone to put up $600,000 for a 20 percent interest in Lori Corporation and Associate. The same transaction gave Lori Corporation a 40 percent interest. Clarence received a 40 percent interest and, of course, had a 94 percent interest in Lori after buying out Milton. On the record before it, the jury could fairly infer that Clarence intentionally misrepresented to Milton the financial prospect for the Maison Dupuy Hotel and that he concealed material facts from his brother to depress the price of the stock.

The more difficult question is the extent to which fraud under Rule 10-b is vitiated by the victim's lack of diligence in protecting his interests.

II.
DUE DILIGENCE

a. *Judgment Notwithstanding the Verdict.*

The trial judge overturned the jury verdict because he found that the record showed no evidence that Milton had exercised due diligence to protect his own interests.

This Court, in *Boeing Co. v. Shipman*, 5 Cir. 1969, 411 F.2d 365 (en banc), limited our inquiry in this type of case to the question whether the district court improperly substituted its judgment for that of the jury:

> [T]he Court should consider all of the evidence — not just that evidence which supports the non-mover's case — but in the light and with all reasonable inferences most favorable to the party opposed to the motion. . . . [I]f there is substantial evidence opposed to the motions, that is, evidence of such quality and weight that reasonable and fair-minded men in the exercise of impartial judgment might reach different conclusions, the motions should be denied, and the case submitted to the jury. . . . There must be a conflict in substantial evidence to create a jury question. However, it is the function of the jury as the traditional finder of the facts, and not the Court to weigh conflicting evidence and in-

ferences, and determine the credibility of witnesses.

Id. at 374-75. We need not resolve the swearing match. We need decide only whether a reasonable jury could have found from the evidence that Milton exercised due diligence under Section 10b-5, in the circumstances of this case, to protect his interests before he sold his stock to Clarence.

b. The Law of Due Diligence.

1. *Background and Approach*

The Securities and Exchange Act of 1934 did not provide expressly for a private cause of action to enforce Section 10-(b). Neither the Act nor its legislative history supply the elements of such an action.[11] When the SEC promulgated Rule 10b-5, apparently it intended to exercise its broad enforcement powers, rather than to establish a mechanism for investor compensation.[12] Consequently, the Commission also failed to announce the prerequisites for recovery of damages by victims of stock fraud. Not until *J. I. Case Co. v. Borak*, 1964, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423, did the Supreme Court recognize a private cause of action arising from the Acts. The burden has fallen upon the courts to define the requirements for private enforcement of the securities laws.

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[11] *See* Wheeler, *Plaintiff's Duty of Due Care Under Rule 10b-5; An Implied Defense to an Implied Remedy*, 70 Nw.U.L.Rev. 561, 564-68 (1976); Comment, *Reliance Under Rule 10b-5: Is the Reasonable Investor "Reasonable"?* 72 Colum.L.Rev. 562, 563 (1972).

[12] *Id.*

The courts have established that with regard to private recovery for the violation of Rule 10b-5, a properly stated cause of action must establish the scienter of the defendant,[13] the materiality of any misrepresentation or omission by the defendant,[14] the extent of actual reliance by the plaintiff on the defendant's statements,[15] and the justifiability of the reliance, frequently translated into a requirement of due diligence by the plaintiff.[16] Treatment of the last of these elements has varied substantially among the circuits. This Court established "due diligence" as a separate element in 10b-5 cases, apart from questions of materiality, reliance, or defendants' duties. *Clement A. Evans & Co. v. McAlpine*, 5 Cir. 1970, 434 F.2d 100, *cert. denied*, 1971, 402 U.S. 988, 91 S.Ct. 1660, 29 L.Ed.2d 153, *rehearing denied*, 404 U.S. 874, 92 S.Ct. 26, 30 L.Ed.2d 120; *accord Bird v. Ferry*, 5 Cir. 1974, 497 F.2d

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[13] *Ernst & Ernst v. Hochfelder*, 1976, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668.

[14] *Schlick v. Penn-Dixie Cement Corp.*, 2 Cir. 1974, 507 F.2d 374, *cert. denied*, 1975, 421 U.S. 976, 95 S.Ct. 1976, 44 L.Ed.2d 467; *Arber v. Essex Wire Corp.*, 6 Cir. 1974, 490 F.2d 414, *cert. denied*, 419 U.S. 830, 95 S.Ct. 53, 42 L.Ed.2d 56; *Rogen v. Ilikon Corp.*, 1 Cir. 1966, 361 F.2d 260, 266.

[15] *Holdsworth v. Strong*, 10 Cir. 1976, 545 F.2d 687; *Titan Group, Inc. v. Faggen*, 2 Cir. 1975, 513 F.2d 234; *cert. denied*, 423 U.S. 840, 96 S.Ct. 70, 46 L.Ed.2d 59; *Rochez Bros. v. Rhoades*, 3 Cir. 1974, 491 F.2d 402. The Supreme Court has held that proof of actual reliance is not required when defendants have omitted information rather than misrepresenting it. *Affiliated Ute Citizens v. United States*, 1972, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741. Reliance on the omission generally is presumed if the omission is material. *See, e.g., Competitive Associates v. Laventhal, Krekstein, Horwath & Horwath*, 2 Cir. 1975, 516 F.2d 811.

[16] *Holdsworth v. Strong*, 10 Cir. 1976, 545 F.2d 687; *Straub v. Vaisman & Co.*, 3 Cir. 1976, 540 F.2d 591; *Vohs v. Dickson*, 5 Cir. 1974, 495 F.2d 607; *Rochez Bros v. Rhoades*, 3 Cir. 1974, 491 F.2d 402; *Clement A. Evans & Co. v. McAlpine*, 5 Cir. 1970, 434 F.2d 100, *cert. denied*, 1971, 402 U.S. 988, 91 S.Ct. 1660, 29 L.Ed.2d 153, *rehearing denied*, 404 U.S. 874, 92 S.Ct. 26, 30 L.Ed.2d 120.

112, *rehearing denied,* 5 Cir., 503 F.2d 567; *Vohs v. Dickson,* 5 Cir. 1974, 495 F.2d 607.[17] By considering independently whether the carelessness of a plaintiff should preclude his recovery, the Court promotes two policies. First, general principles of equity suggest that only those who have pursued their own interests with care and good faith should qualify for the judicially created private 10b-5 remedies. *See Clement A. Evans & Co. v. McAlpine,* 5 Cir. 1970, 434 F.2d 100, 104; *City National Bank v. Vanderboom,* 8 Cir. 1970, 422 F.2d 221, 230 n.10, *cert. denied,* 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d 560; Wheeler, *Plaintiff's Duty of Due Care Under Rule 10b-5: An Implied Defense to an Implied Remedy,* 70 Nw.U.L.Rev. 561, 564-68 (1976) (hereinafter cited Wheeler). Second, by requiring plaintiffs to invest carefully, the Court promotes the anti-fraud policies of the Acts and engenders stability in the markets. Wheeler, 70 Nw.U.L. Rev. at 585; Note, *The Due Diligence Requirement for Plaintiffs Under Rule 10b-5,* 1975 Duke L.J. 753, 760-61.

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[17] *But see Stier v. Smith,* 5 Cir. 1973, 473 F.2d 1205, which did not examine the diligence of a plaintiff who had been induced to purchase stock from a corporate insider. The Court said:

> We should always be wary of holding that a purchaser of securities, who deals with the corporate insider, could have found out omitted material facts, by examining the corporate books or undertaking other extensive investigations. To do so is to allow the insider to present prospective purchasers with a mountain of information which they cannot possibly digest and excuse themselves from liability on the basis that they did not provide the right answers because they were not asked the right questions. *Id.* at 1208.

Rather than concluding that the plaintiff had fulfilled the limited requirements of due care imposed on an outsider, *see Bird v. Ferry,* 5 Cir. 1974, 497 F.2d 112, the Court merely held that Stier "was entitled to judgment as a matter of law because sophisticated investors, like all others, are entitled to the truth". 473 F.2d at 1207.

Some other circuits used different approaches in evaluating the conduct of plaintiffs. Several courts have made the duty of defendants to disclose depend on the sophistication, status, and information of the plaintiff. *White v. Abrams,* 9 Cir. 1974, 495 F.2d 724; *Arber v. Essex Wire Corp.,* 6 Cir. 1974, 490 F.2d 414, *cert. denied,* 419 U.S. 830, 95 S.Ct. 53, 42 L.Ed.2d 56; *Kohler v. Kohler,* 7 Cir. 1963, 319 F.2d 634. The First and Tenth Circuits have analyzed the facts to determine whether reliance by plaintiffs on misrepresentations was reasonable or justifiable. *Holdsworth v. Strong,* 10 Cir. 1976, 545 F.2d 687; *Rogen v. Ilikon Corp.,* 1 Cir. 1966, 361 F.2d 260. One panel in the Second Circuit has abandoned altogether the requirements of reliance in fact and justifiable reliance in cases involving intentional misrepresentations. In *Metro-Goldwyn-Mayer, Inc. v. Ross,* 2 Cir. 1975, 509 F.2d 930, the court held that the duty of the defendant to correct his misrepresentation is absolute, regardless of the defendant's knowledge of the misrepresentation. *Accord, Competitive Associates, Inc. v. Laventhol, Krekstein, Horwath & Horwath,* 2 Cir. 1975, 516 F.2d 811. *But see Titan Group, Inc. v. Faggen,* 2 Cir. 1975, 513 F.2d 234, *cert. denied,* 423 U.S. 840, 96 S.Ct. 70, 46 L.Ed.2d 59. *See generally,* Comment, *Securities Regulation — Two Different Standards of Reliance Applied in Individual Private Damage Actions Under SEC Rule 10b-5 by the Second Circuit,* 49 Temple L.Rev. 182 (1975).

These alternative approaches to the due diligence determination present several analytical problems, which cause us to retain the methodology of *McAlpine.*

First, inconsistent standards of conduct for defendants arise from analyses that vary the duty to disclose with the status of the plaintiff. Because the private 10b-5 cause of action derives from a prohibitory SEC rule, the standard of conduct for defendants logically should be the same whether the SEC or a private litigant enforces the duty. In an SEC enforcement proceeding, the due care of the victim generally does not receive consideration. *SEC v. Dolnick,* 7 Cir. 1974, 501 F.2d 1279, 1283 (disregarding whether the victim was a knowledgable investor); *Hanly v. SEC,* 2 Cir. 1967, 415 F.2d 589, 596 (disregarding the sophistication of the victims, as well as their previous relationships with the defendants). *But see SEC v. Coffey,* 6 Cir. 1974, 493 F.2d 1304, 1312-13, *cert. denied,* 1975, 420 U.S. 908, 95 S.Ct. 826, 42 L.Ed.2d 837 (on the peculiar facts of this case the defendant violated no duty because the victims possessed sufficient knowledge about a representation to avoid being misled by it). The dispositive element in these cases is that the defendant owes a duty of full and fair disclosure to the public, not to any particular investor. Whether a private plaintiff might be precluded from recovery, then, need not alter the distinct consideration whether a defendant has violated duties imposed by the Act. With a flexible duty approach, however, the defendant owes different duties depending on the status of the victim and the type of legal action. This could lead both to unnecessary confusion between public and private enforcement proceedings and to gamesmanship by defendants. *See* Wheeler, 70 Nw. U.L.Rev. at 591.

Second, the materiality-reliance approach of the First and Tenth Circuits also faces a problem of consistency of application. In *Affiliated Ute Citizens v. United States,* 1972, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741, *rehearing denied,* 407 U.S. 916, 92 S.Ct. 2430, 32 L.Ed.2d 692 and 408 U.S. 931, 92 S.Ct. 2478, 33 L.Ed.2d 345, the Supreme Court held that in a 10b-5 case involving a material omission "positive proof of reliance is not a prerequisite to recovery". *Id.* 406 U.S. at 153, 92 S.Ct. at 1472. By eliminating positive proof of reliance when materiality is established, the Court relieved the plaintiffs from an almost impossible burden of proof. *See Holdsworth v. Strong,* 10 Cir. 1976, 545 F.2d 687, 695; *Jackson v. Oppenheim,* S.D.N.Y. 1974, 411 F.Supp. 659. *Ute Citizens* creates a distinction between affirmative misrepresentation cases, in which plaintiffs must demonstrate reliance on the assertions of defendants, and omission cases, in which such proof is not required. When due care is discussed in terms of reliance, then, the misrepresentation-omission distinction could remove from plaintiffs the responsibility of exercising due care to protect their interests in omission cases. If reliance never becomes an issue, in other words, a court will have no basis to assess the justifiability of that reliance.

The purposes of examining the diligence of a 10b-5 plaintiff, however, do not justify distinguishing between misrepresentations and omissions. As we have suggested, courts have used due diligence to limit, as a matter of equitable discretion, recoveries to those parties who have purchased securities with care and good faith. Courts have also viewed the due diligence requirement as a method to promote statutory policies encouraging investor diligence in the interest of the efficiency and stability of the securities markets. These purposes for the due diligence requirement, whatever its form, do not vanish in omissions cases. As diligence can reveal misrepresentations, it can also reveal omissions. After *Ute Citizens*, then, tying the diligence analysis to reliance can generate an improper distinction between the misrepresentation and omission causes of action.

Third, to abandon completely the consideration of reliance in fact and reasonable reliance ignores not only the above policies of due diligence but also the need for a causal link between the misrepresentation or omission and the injury suffered by the private plaintiff. The cause of action would no longer provide compensation for losses occasioned by the violation of the Act because a plaintiff could sue without relying on the fraud. This would transform the action into an enforcement mechanism. We reject this approach because of the Supreme Court's recognition of a 10b-5 private action as a device to compensate victims of stock fraud and thereby to promote the public objections of the Act. *J. I. Case Co. v. Borak*, 377 U.S. at 432-35, 84 S.Ct. 1555.

As we see it, the *McAlpine* approach of treating due diligence as a separate element in private 10b-5 cases best supports the policies of the Acts and ensures proper exercise of the Court's equity powers.

2. *The Subjective Elements of the Due Diligence Consideration.*

The diligence of the plaintiff in 10b-5 cases is judged subjectively. *Straub v. Vaisman & Co.*, 3 Cir. 1976, 540 F.2d 591, 598; *Clement A. Evans & Co. v. McAlpine*, 5

Cir. 1970, 434 F.2d 100, 102. The role model for a plaintiff, then, is an investor with the attributes of the plaintiff, rather than the average investor. For example, *McAlpine* approved a jury instruction that imposed a duty of due diligence "solely under the peculiar circumstances of each case, including existence of a fiduciary relationship,[18] concealment of the fraud,[19] opportunity to detect it,[20] position in the industry,[21] sophistication and expertise in the financial community,[22] and knowledge of related proceedings". Several courts have also considered whether the plaintiff initiated the stock transaction or pressured for a speedy resolution. *White v. Abrams*, 9 Cir. 1974, 495 F.2d 724; *Hafner v. Forest Laboratories, Inc.*, 2 Cir. 1965, 345 F.2d 167; *Kohler v. Kohler Co.*, 7 Cir. 1963, 319 F.2d 634.

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[18] *Accord, e. g., Holdsworth v. Strong*, 10 Cir. 1976, 545 F.2d 687; *Straub v. Vaisman & Co.*, 3 Cir. 1976, 540 F.2d 591; *Bird v. Ferry*, 5 Cir. 1974, 497 F.2d 112; *rehearing denied*, 503 F.2d 567; *Rogen v. Ilikon Corp.*, 1 Cir. 1966, 361 F.2d 260.

[19] *Accord, e. g., Myzel v. Fields*, 8 Cir. 1967, 386 F.2d 718, *cert. denied*, 1968, 390 U.S. 951, 88 S.Ct. 1043, 19 L.Ed.2d 1143.

[20] Most courts analyze whether the plaintiff has effective access to information about the fraud. *E. g., Holdsworth v. Strong*, 10 Cir. 1976, 545 F.2d 687; *Straub v. Vaisman & Co.*, 3 Cir., 1976, 540 F.2d 591; *Rochez Bros. v. Rhoades*, 3 Cir. 1974, 491 F.2d 402; *Kohler v. Kohler Co.*, 7 Cir. 1963, 319 F.2d 634.

[21] Most courts give weight to the plaintiff's being a corporate insider. *E. g., Holdsworth v. Strong*, 10 Cir. 1976, 545 F.2d 687; *Bird v. Ferry*, 5 Cir. 1974, 497 F.2d 112; *Myzel v. Fields*, 8 Cir. 1967, 386 F.2d 718.

[22] *Accord, e. g., Holdsworth v. Strong*, 10 Cir. 1976, 545 F.2d 687; *Straub v. Vaisman & Co.*, 3 Cir. 1976, 540 F.2d 591; *Myzel v. Fields*, 8 Cir. 1967, 386 F.2d 718; *Rogen v. Ilikon Corp.*, 1 Cir. 1966, 361 F.2d 260.

3. *The Standard of Care.*

This Court has announced a due diligence test that measures the plaintiff's conduct against that of a reasonable investor with the attributes of the plaintiff. It is, in effect, a negligence standard. *Clement A. Evans & Co. v. McAlpine,* 5 Cir. 1970, 434 F.2d 100, 103, quoted with approval the test employed by the Eighth Circuit:

> With regard to misrepresentations, the question is whether a reasonable investor, in light of the facts existing at the time of the misrepresentation and in the exercise of due care, would have been entitled to rely upon the misrepresentation. . . .

McAlpine answered that question in the negative and affirmed a jury finding that the plaintiff lacked "reasonable diligence". *Accord, Bird v. Ferry,* 5 Cir. 1974, 497 F.2d 112; *Vohs v. Dickson,* 5 Cir. 1974, 495 F.2d 607.

Recently, however, an important reexamination has begun of the appropriateness of applying a negligence standard to the conduct of plaintiffs when the Supreme Court has forbidden a similar standard to be applied to the conduct of defendants. In *Ernst & Ernst v. Hochfelder,* 1976, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668, the Court reversed an imposition of 10b-5 liability without proof of scienter — "intent to deceive, manipulate, or defraud". *Id.* at 193, 96 S.Ct. at 1381. Ernst & Ernst, an accounting firm, had not intentionally defrauded the plaintiffs. The firm had contracted to audit a brokerage house, the president of

which had perpetrated an intentional fraud. During the audit Ernst & Ernst failed to test adequately the internal control system of the company and thereby breached a common law and statutory duty to do so. Nevertheless, the Court refused to impose 10b-5 liability on the accountants because they had not acted with scienter, which the text of the opinion equated with intent. A footnote qualified the Court's holding:

> In this opinion the term "scienter" refers to a mental state embracing intent to deceive, manipulate or defraud. In certain areas of the law recklessness is considered to be a form of intentional conduct for the purposes of imposing liability for some act. We need not address here the question whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5.

Id. at 194 n. 12, 96 S.Ct. at 1381.[23]

Two circuits have reevaluated their due diligence standards in light of *Ernst*. In *Holdsworth v. Strong,* 10 Cir. 1976, 545 F.2d 687, the plaintiff, Holdsworth, sold his stock in a close corporation to Strong. Although Holdsworth was a sophisticated insider with access to company books, he relied on several intentional misrepresentations by Strong about the financial health of the company. Citing *McAlpine* and *Rochez Bros. v. Rhoades,* 3 Cir. 1974, 491 F.2d 402, the court recognized that the traditional due diligence requirement imposed a standard of negligence on plaintiffs. But it decided that *Ernst* called for a change:

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[23] At least one commentator has argued after *Ernst* that the scienter standard should and will include recklessness. Bucklo, *The Supreme Court Attempts to Define Scienter Under Rule 10b-5: Ernst & Ernst v. Hochfelder,* 29 Stan.L.Rev. 213, 227 n. 99, 235-36, 239-40 (1977).

> If the negligence standard were being applied it might be appropriate to allow due diligence to be exacted from the victim, but where liability of the defendant requires proof of intentional misconduct, the exaction of a due diligence standard from the plaintiff becomes irrational and unrelated.

545 F.2d at 692. Consequently, the Court held that contributory fault would bar recovery only when plaintiff exhibited "gross conduct somewhat comparable to that of defendant". *Id.* at 693.

In *Straub v. Vaisman & Co.*, 3 Cir. 1976, 540 F.2d 591, the Court responded to *Ernst* by reversing the burden of proof on the due diligence issue. The plaintiff, the European manager of a portfolio management company, executed an unsuccessful stock purchase on the defendant's advice. In assessing the manager's diligence, the Court noted several arguments for circumscribing the due care requirement.[24] But it balanced the effect of *Ernst* against the general SEC policy of encouraging diligence in stock transactions. As a result, it continued to require that plaintiffs act reasonably, and it made the due care question an affirmative defense. On the facts, the American defendant did not carry his burden of proof primarily because the Europeans lacked access to information concerning the abuse of their trust.

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[24] *See* text at note 25 *infra*.

These cases and commentary have developed several reasons for changing the due diligence standard after *Ernst*. They first draw analogies to tort theory. *Holdsworth v. Strong*, 10 Cir. 1976, 545 F.2d 687, 693-95; *Straub v. Vaisman & Co.*, 3 Cir. 1976, 540 F.2d 591, 597; Wheeler, 70 Nw. U.L.Rev. at 575. This is not an innovative approach, although a justifiable one for courts attempting to define the scope of judicially created remedies. *See, e. g., Blue Chip Stamps v. Manor Drug Stores*, 1975, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539; *List v. Fashion Park, Inc.*, 2 Cir. 1965, 340 F.2d 457, *cert. denied sub nom.; List v. Lerner*, 382 U.S. 811, 86 S.Ct. 23, 15 L.Ed.2d 60, *rehearing denied*, 382 U.S. 933, 86 S.Ct. 305, 15 L.Ed.2d 60; 3 L. Loss Securities Regulation, 1759-1763; 6 L. Loss, 3880 *et seq.*; Comment, *Negligent Misrepresentations Under Rule 10-b*, 32 U. Chi.L.Rev. 824, 828-33 (1965). Tort law distinguishes between intentional misrepresentations and negligent ones. Contributory negligence may bar recovery for the latter, but not for the former:

> [W]here there is an intent to mislead, [barring recovery] is clearly inconsistent with the general rule that mere negligence of the plaintiff is not a defense to an intentional tort. The better reasoned cases have rejected contributory negligence as a defense applicable to intentional deceit.

W. Prosser, Handbook of the Law of Torts § 10 at 716 (4th ed. 1971) (hereinafter cited W. Prosser). The Restatement of Torts agrees:

> The recipient in a business transaction of a fraudulent misrepresentation of fact is

> justified in relying on its truth, although he might have ascertained the falsity of the representation had he made an investigation.

Restatement of Torts § 540 (1938). The American Law Institute rejected any change in this rule when it considered the Restatement Second. *See* 42 ALI Proceedings 331 (1965), *rejecting* Restatement (Second) of Torts § 540 (Tent. Draft No. 11, 1965).

Two theories support the tort law dichotomy. First, the policy of deterring intentional misconduct outweighs that of deterring negligent behavior. This constitutes a change in tort philosophy from the period dominated by the concept of caveat emptor. W. Prosser, § 108 at 717. "The recognition of a new standard of business ethics, demanding that statements of fact be at least honestly and carefully made, and in many cases that they be warranted to be true, has led to an almost complete shift in this point of view." *Id.* Second, comparative culpability influences the determination of who should bear any given loss. When both parties are negligent, there may be no reason for the judicial system to shift the loss from the victim. *See id.* at § 65. When one inflicts a loss intentionally on a negligent victim, however:

> [s]uch conduct differs from negligence not only in degree but in kind, and in the social condemnation attached to it. . . . . It is in reality a rule of comparative fault which is being applied, and the court is refusing to set up the lesser fault against the greater.

Id. at § 65 at 426. Of course, other factors, such as the comparative abilities of the parties to spread losses fairly also influence the allocation decision. Such factors have led to increasing dissatisfaction with the concept of contributory negligence. *See* James, *Contributory Negligence,* 1953, 62 Yale L.J. 691; W. Prosser, § 64 at 418.

The strength of the tort law analogy is enhanced by the similarity of policy arguments derived from the Securities Acts. Just as principles of tort law are intended to deter intentional misconduct, one of the principal policies behind the Acts is "to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing". *Ernst & Ernst v. Hochfelder,* 1976, 425 U.S. 185, 195, 96 S.Ct. 1375, 1382, 47 L.Ed.2d 668, *citing* H.R.Rep. No. 85, 73d Cong., 1st Sess., 1-5 (1933). Regarding Section 10b-5 specifically, the *Ernst* opinion, besides limiting the bases on which liability may be imposed, also demonstrates the strength of congressional intent to "prevent 'manipulative and deceptive practices which . . . fulfill no useful function' ". 425 U.S. at 206, 96 S.Ct. at 1387, *citing* S.Rep. No. 792, 73d Cong., 2d Sess., 12-13 (1934); H.R. Rep. No. 1383, 73d Cong., 2d Sess., 10-11, 20-21 (1934). The prospect of unreasonable behavior by investors apparently did not generate such concern; at least the legislative history does not speak of it. It is therefore fair to say that the federal policy of deterring intentional misconduct in securities dealings outweighs the policy of deterring negligent behavior by investors.

This argument leads to the conclusion that nothing in the Act requires disregard for the comparative equities of the parties. If it is fairer for a judicially allocated loss to fall upon the more culpable actor under tort law, the judicially created remedial system for the Securities Acts can respond to similar notions of equity without disrupting the legislative scheme.[25]

Still another reason to adhere to this approach is that *Ernst* diminished substantially the need to limit the scope of the 10b-5 remedy. Before *Ernst,* tremendous liability could result from the negligent behavior of any person connected with a stock sale or purchase. For accountants, lawyers, brokers, dealers. and underwriters who handled these transactions, this potential liability posed a substantial risk to their professional existence. The principle of due diligence and other elements of the private cause of action provide mechanisms for limiting potential liability. *See Clement A. Evans & Co. v. McAlpine,* 5 Cir. 1970, 434 F.2d 100, 104. With the scienter requirement, liability will be imposed only upon reckless or intentional wrongdoers, reducing substantially the risk on most actors in securities transactions. The need, then, for further limitation by the reasonable diligence requirement becomes questionable. Indeed, the Tenth Circuit has argued that requiring proof of both the scienter of the defendant and the reasonable diligence of the plaintiff would impermissibly limit 10b-5 recoveries to the "extraordinary" cases. *Holdsworth v. Strong,* 10 Cir. 1976, 545 F.2d 687, 693.

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[25] *But see* Wheeler, 70 Nw.U.L.Rev. at 586.

The final argument for relaxing the reasonable diligence standard after *Ernst* is that most 10b-5 cases, when limited to their facts, are consistent with the distinction between intentional and negligent misrepresentation. In *Carroll v. First National Bank,* 7 Cir. 1969, 413 F.2d 353, *cert. denied,* 1970, 396 U.S. 1003, 90 S.Ct. 552, 24 L.Ed.2d 494, for example, the Court said:

> whatever the relevance of plaintiffs' negligence might be to the issues at a trial on the merits, it does not support the dismissal of the amended complaint which is based on fraud rather than negligence.

Id. at 358. Other cases that required plaintiffs to act reasonably did not require proof of intentional misconduct by defendants. *E. g., White v. Abrams,* 9 Cir. 1974, 495 F.2d 724; *Vohs v. Dickson,* 5 Cir. 1974, 495 F.2d 607; *Arber v. Essex Wire Corp.,* 6 Cir. 1974, 490 F.2d 414; *City National Bank v. Vanderboom,* 8 Cir. 1970, 422 F.2d 221; *Rogen v. Ilikon Corp.,* 1 Cir. 1966, 361 F.2d 260; *Jackson v. Oppenheim,* S.D.N.Y.1974, 411 F.Supp. 659. *See* A. Bromberg, Securities Law-Fraud SEC Rule 10b-5 § 8.4(652) (1971). Indeed, because most cases before *Ernst* did not require scienter, they can be read consistently with the distinction between intentional and negligent misrepresentation cases.[26]

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[26] The clearest exception to this general proposition in *McAlpine:*

> While the commentator quoted by the court couched his language in the context of negligent misrepresentations, we are of the view that plaintiff's duty above espoused is not altered merely because the misrepresentations are alleged to be intentional rather than negligent.

434 F.2d at 104. After *Ernst,* however, we view the due diligence rule from a different perspective. To begin with, the above policy

We consider that *Ernst & Ernst v. Hochfelder* prompts a change in the law of due diligence, as it is applicable in 10b-5 cases. Both tort law and federal securities policy support imposing on the plaintiff only a standard of care not exceeding that imposed on the defendant. Although the "scienter" requirement may still be unsettled, the Supreme Court has imposed on defendants a standard not stricter than recklessness. In this case, then, the question should not be whether Milton acted unreasonably by failing to investigate the condition of Lori Corporation. Instead, the Court should ask whether Milton intentionally refused to investigate "in disregard of a risk known to him or so obvious that he must be taken to have been aware of it, and so great as to make it highly probable that harm would follow." W. Prosser, § 34 at 185 (1971).

4. *The Due Diligence of Milton.*

After reviewing the voluminous trial record, we hold that a reasonable jury could find that Milton did not act recklessly when he sold his stock.

The district court's instructions were, as we view

them, more favorable to Clarence than to Milton.[27] The district court instructed the jury that to recover Milton must prove that he acted reasonably, an instruction consistent with previous holdings of this Court. The jury found that Milton had met this burden of proof — that he had acted reasonably; "with due diligence" (the language of the court's interrogatory). After *Ernst*, the jury did not have to decide whether Milton acted negligently, but only that he did not act recklessly. We reinstate the jury's verdict, then, because there is sufficient evidence in the record to support a holding that Milton did not have knowledge of the risk of Clarence's forming the partnership with Monteleone and obtaining financing for the hotel. There is also sufficient evidence to support a jury conclusion that Milton did not act in intentional disregard of whether Clarence had taken this course of action.

Whether Milton knew of the risk of Clarence's having formed a partnership with Monteleone poses a jury question. Milton testified that Monteleone's name arose only once as a possible purchaser of some of Milton's stock. He denies that he ever discussed Monteleone with Harris or Merrigan or Perez. And he insists that Clarence never informed him of the negotiations and partnership. On the other hand, Clarence submits that Milton knew of the possibility

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arguments, not discussed at all in *McAlpine*, provide substantial support for a change. Furthermore, the *McAlpine* opinion does not indicate whether the plaintiff proved that the defendants had perpetrated an intentional fraud. From the Court's brief factual discussion, *McAlpine* probably intended the deception. But his codefendants, another stock broker and his firm, may have only acted negligently. Thus the facts of the case are somewhat distinguishable from *Dupuy*, where the district court expressly conditioned liability on proof of intentional or reckless behavior.

[27] The district court instructed the jury, in part:

> In addition, he must prove that his reliance was reasonable under all the circumstances at the time.
>
> In this way, recovery is denied those who, because of their business sophistication, their acumen or, ready access to information involved, could reasonably be expected to exercise a higher degree of care and investigation in their dealings and thus, have discovered for themselves, the misrepresentation or omission.

of the partnership in March. Harris testified that he discussed with Clarence and Milton the possibility of tapping Monteleone as a source of financing. Merrigan and Perez also recall meetings at which the brothers mentioned Monteleone as an investor. And their mother stated that Milton himself informed her of the partnership. Nevertheless the jury, as the fact finder, assesses the credibility of these witnesses and resolves this factual dispute. *Boeing Co. v. Shipman,* 5 Cir. 1969, 411 F.2d 365, 375. If the jury believed Milton's testimony, then, it could have reasonably concluded that Milton knew nothing of the risk of the partnership having been created.[28]

The traditional factual considerations of due diligence analyses do not require a conclusion contrary to that of the jury. Milton testified that he had no effective access to information about Monteleone. Besides Clarence, knowledge of the partnership could have come only from Merrigan, Harris, or Perez. But, according to Milton, these men did not provide effective access; he had no reason to connect them to a partnership about which he knew nothing. *Rogen v. Ilikon Corp.,* 1 Cir. 1966, 361 F.2d 260, supports his position. The defendants in *Rogen* failed to reveal secret business negotiations and technical developments to the plaintiff before he sold his stock to them. In that case the plaintiff even knew of the possibility of the important business deal. The secret nature of the negotiations, however, prompted the Court to give the access question to the jury. An independent investigation outside the corporation was not required. *See also, Holdsworth v. Strong,* 10 Cir. 1976, 545 F.2d 687. Similarly, because of Milton's lack of effective access to information about the Monteleone transaction, the jury could reasonably have concluded that he did not know of the likelihood that the partnership had been created.

In spite of the friction between the brothers, the jury could reasonably conclude that Milton, holding a 47 percent interest in Lori, could not foresee that the corporation would enter into a partnership with Monteleone and with Clarence individually and assign to the partnership Lori's sole asset. Nor could Milton foresee that this could be accomplished without notice to him of the non-existent board meeting and of the resolutions that Clarence certified as having been adopted by the board at a lawful meeting. In the past, Milton had cosigned or had known of Clarence's signing resolutions required for their various transactions. Clarence had a month to tell Milton of the good fortune that had benefitted Lori. During this period Milton's health had deteriorated, as a result of which he was no longer able to work.

Clarence argues that a higher standard of diligence should be required of Milton because he was a corporate insider of Lori. Although insider status can influence the due diligence consideration, Clarence does not correctly apply the element to the facts of this case. *Rogen* again suggests the proper application. In that case the plaintiff was the president and co-founder of a small metals research company. The defendants, other co-founders, removed him from office because of dissatisfaction with his performance. After the later sold his stock to the defendants, he alleged that they had failed to reveal important information. The Court approached the due diligence problem by examining whether the plaintiff, as a matter of law, could not have relied on the omissions. The district court had issued a summary judgment order for the defendants on this issue because (a) Rogen was a corporate insider, intimately involved with the development of the small company; (b) he had retained his position on the board of directors after his dismissal as president; (c) he did not investigate the status of the corporation before selling his stock; and therefore (d) he was not interested in the current developments of the company. The Court of Appeals reversed, holding that a question of fact existed and the jury should assess Rogen's reliance because (a) he was not sophisticated in investing; (b) he trusted the other insiders; (c) he thought company employees would not cooperate with him in any investigation; and most importantly (d) he might have lost any meaningful access to information about the company despite his former role and current board position.

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[28] The price at which Milton's stock was sold — whether he or Clarence told the truth about the price — is strong evidence that he did not know or have reason to think that Clarence had consummated an agreement with Monteleone.

The important factors in the district and circuit court opinions in *Rogen* also appear in this case. Both cases involve an insider whose role in the corporation diminished, who retained a corporate title, who did not investigate the company's prospects before selling his stock, and who says he trusted other insiders for information. The lesson of *Rogen* should apply here: The due diligence analysis should not react reflexively to the titles of apparent insiders. The principal consideration should be whether the plaintiff, by virtue of his position, has access in fact to the particular information needed to uncover the fraud. The insider status of a plaintiff has generally been of significance only in those cases when the fraud involved financial data easily available in company books. *See, e. g., Kohler v. Kohler Co.*, 7 Cir. 1963, 319 F.2d 634; *Jackson v. Oppenheim*, S.D.N.Y.1974, 411 F.Supp. 659. But if the pertinent information concerns private negotiations not apparent on the corporate books, or if the insider has lost effective access to information, the significance of his insider status diminishes.[29] Thus a reasonable jury could have disregarded Milton's insider status because of his lack of effective access to information about the Monteleone negotiations and partnership.

The alternative question posed by the recklessness standard is whether Milton acted intentionally in disregard of the probability that Clarence had organized the partnership and obtained financing. Two factors indicate that Milton intentionally sold his stock in disregard of all chances for success. First, the parties agree that the sale occurred, without any independent investigation by Milton into the affairs of Lori. Although he knew Merrigan, Perez, and Harris, he did not discuss the sale with them. He relied exclusively on Clarence's representations. Second, Milton initiated the sale negotiations and exerted pressure for a quick agreement. According to Milton, he first wanted to sell his interest in several other properties to generate cash. Later, in April or May, he suggested a sale of the hotel stock. Clarence put him off; he needed time to raise the money. Clarence reported that their mother first informed him of Milton's desire to sell his interest in the hotel venture. Clarence also said that his mother badgered him about the sale on Milton's behalf until the brothers met in June and, according to Clarence, agreed on a price of $45,000 — $35,000 in cash and $10,000 in check. Milton testified that this meeting never occurred; that is, that there was never any firm agreement as to the time or amount. The June and July letters show that Milton distrusted Clarence, wanted to sell, but that Clarence procrastinated.

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[29] The principal 10b-5 case cited by Clarence for his insider argument is *Myzel v. Fields*, 8 Cir. 1967, 386 F.2d 718. Although *Myzel* notes the importance of both insider status and business sophistication, it held that the diligence of the plaintiff in the case created a jury question. The dispositive fact was the skillfulness of the fraud perpetrated by the defendants. The defendants had concealed the true identity of the purchaser of the stock sold by the plaintiff. Because they had developed a convincing scheme, the Court refused to say as a matter of law that a sophisticated, corporate insider should have uncovered misrepresentation by Clarence. And we cannot say as a matter of law that Milton was reckless in his failure to uncover the Monteleone partnership.

As *Myzel* indicates, an argument similar to Clarence's position on the insider status of his brother can be made regarding Milton's business sophistication. *See, e. g., Straub v. Vaisman & Co.*, 3 Cir. 1976, 540 F.2d 591; *Clement A. Evans Co. v. McAlpine*, 5 Cir. 1970, 434 F.2d 100. But the cases indicate that the effect of sophistication is diminished substantially by a lack of effective access to information. *Rochez Bros. v. Rhoades*, 3 Cir. 1974, 491 F.2d 402; *Lehigh Valley Trust Co. v. Central National Bank*, 5 Cir. 1969, 409 F.2d 989; *Myzel v. Fields*, 8 Cir. 1967, 386 F.2d 718.

At least two Courts of Appeals have decided that such conduct indicates a lack of due diligence. In *Kohler v. Kohler Co.*, 7 Cir. 1963, 319 F.2d 634, the plaintiff-seller, the governor of Illinois, pressed for a speedy sale because he wanted to avoid any political problems that company labor conflict might generate. This pressure in part led the court to approve conduct by the defendant "that might not be fair if plaintiff had been a novice to stock transactions or the corporation's activities". *Id.* at 642. Under the flexible duty approach announced in *White v. Abrams*, 9 Cir. 1974, 495 F.2d 724 initiation of the sale can cut for or

against either party, depending on the peculiar facts of each case.

On the facts of this case, however, a jury could find justification for Milton's conduct. First, according to his testimony, he repeatedly discussed the corporation and the stock sale with Clarence, the only other principal of Lori and the most obvious source of information about the venture.[30] Even the cases that have required plaintiffs to refrain from negligent, rather than reckless, behavior have never required a plaintiff to launch an investigation of sources of information outside the corporation, its officers, directors, and

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[30] Milton argues that because Clarence was his brother and lawyer, he was justified in relying on Clarence. Despite the presence of these special relationships, the record also suggests that Milton did not trust his brother after June 1972. In particular, the three letters to Clarence in June and July accused Clarence of a variety of improprieties and threatening legal and political action. The July letter expressly warns that Milton might soon retain a lawyer. Thus any argument that Milton trusted Clarence because of their attorney-client relationship must be viewed with considerable skepticism. The letters also indicate that Milton considered their harmonious business partnership terminated. Of course, they remained brothers, but Milton even revealed considerable hostility about Clarence's treatment of the family.

This Court recognizes both fiduciary and quasi-fiduciary relationships as relevant to the due diligence decision. *Bird v. Ferry*, 5 Cir. 1974, 497 F.2d 112; *Clement A. Evans & Co. v. McAlpine*, 5 Cir. 1970, 434 F.2d 100. Although *McAlpine* did not apply either element to the facts of the case, *Bird* did discuss the application of a quasi-fiduciary relationship. The founder of an investment club in *Bird* had used club assets for personal speculation and had intentionally misrepresented the financial condition of the organization. The Court did not consider the founder a trustee, but it did decide that the club members had entrusted their investments to his financial judgment. Such entrustment, encouraged by the defendant, created a quasi-fiduciary relationship that permitted the investors to be less diligent than the Court would otherwise have approved.

Because this case is distinguishable from *Bird*, we do not rely on the theory that a fiduciary or quasi-fiduciary relationship existed between Milton and Clarence at the time of the sale.

books. *See, e.g., Rogen v. Ilikon Corp.*, 1 Cir. 1966, 361 F.2d 260; *Kohler v. Kohler Co.*, 7 Cir. 1963, 319 F.2d 634; *Jackson v. Oppenheim*, S.D.N.Y. 1974, 411 F.Supp. 659.

Second, the time that Milton could devote to any such investigation was limited by his search for employment and later by the substantial amount of traveling required by the new job. The jury could have attributed Milton's failure to investigate fully to the financial chaos imposed on him by the abrupt cutoff of his income in March.

Third, the physical debilitation and emotional stress of Milton's kidney disease distracted him significantly during July and August. After discovering the disease in 1965, physicians notified both Milton and Clarence that it was incurable. By August 1972 it had worsened to the point that Milton was forced to quit his new job and to apply for social security. The social security office dated his complete disability from April 1972. When the jury concluded that Milton had exercised due diligence, it is not unreasonable to assume it found that Milton's condition precluded him from investigating the status of Lori. Nothing in the case law forbids or compels the jury to excuse his decision not to investigate on such a ground. Because of the subjective nature of the due diligence determination, then, Milton's ailment could have justified the jury's response to the fourth interrogatory.

The jury found that Milton had acted reasonably in the circumstances when he sold his stock. Implicit in the verdict is the conclusion that he did not act recklessly, which is all that due diligence element requires after *Ernst*. Because we find sufficient evidence to hold that the jury could reasonably have found that Milton was not reckless, we reverse the judgment n. o. v. of the district court[31] and reimpose liability on Clarence for a violation of the duties established by Rule 10b-5.

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[31] As an alternative ground of support for the judgment n. o. v., Clarence argues that Milton's cause of action is barred by the statute of limitations. Because the federal securities laws do not contain a statute of limitation, the period that the forum state applies to the state remedy bearing the closest substantive resemblance to Rule 10b-5 should be utilized. *Sargent v. Genesco, Inc.*, 5 Cir. 1974, 492 F.2d 750; *citing Azalea Meats v. Muscat*, 5 Cir. 1967, 386 F.2d 5. Clarence urges the application of the one-year prescription employed in La.Civ.Code art. 3536. The article is a catch-all provision that does not mention fraud or misrepresentation actions. It applies in part to "offenses and quasi offenses". The only case slightly resembling a 10b-5 action to have utilized the article is *Brown Shoe Co. v. Unter*, La.App.1937, 173 So. 579, which involved the fraudulent procurement of credit. No case under the provision has concerned stock fraud.

A closer analogy can be drawn between Rule 10b-5 and the Louisiana Blue Sky statute, La.Rev.Stat.Ann. § 51.715A(3) and E, which specifically limits the period of potential liability of:

> Any person who:
>
> > Offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading . . . .

The statute promotes the full and accurate disclosure of information in connection with stock sales, precisely the same purpose as that of Rule 10b-5. There are two differences between the section and the Rule: The Louisiana law prohibits only misrepresentations by sellers, and it measures the conduct of defendants against a negligence standard of care. Even with these distinguishing features, however, the Blue Sky statute still bears a closer resemblance to Rule 10b-5 than a catch-all provision dealing with the variety of offenses and quasi offenses in the Louisiana Code. *Accord, Hudak v. Economic Research Analyst, Inc.*, 5 Cir. 1974, 499 F.2d 996, *cert. denied*, 419 U.S. 1122, 95 S.Ct. 805, 42 L.Ed.2d 821; *Parrent v. Midwest Rug Mills, Inc.*, 7 Cir. 1972, 455 F.2d 123; *Vanderboom v. Sexton*, 8 Cir. 1970, 422 F.2d 1233, *cert. denied*, 400 U.S. 852, 91 S.Ct. 47, 27 L.Ed.2d 90. Consequently, Milton's claim is not barred by the two-year Blue Sky statute of limitations because he filed his action before August 29, 1974.

III.
DAMAGES

The district court stated that it would grant a new trial on damages as an alternative resolution to the judgment n. o. v.[32] A trial court has the discretion to order a new trial when it determines a verdict to be "against the clear weight of the evidence". *National Car Rental Systems, Inc. v. Better Monkey Grip Co.*, 5 Cir. 1975, 511 F.2d 724, *cert. denied*, 423 U.S. 894, 96 S.Ct. 193, 46 L.Ed.2d 126 and 423 U.S. 986, 96 S.Ct. 394, 46 L.Ed.2d 303. *United States ex rel. Weyerhaeuser Co. v. Bucon Construction Co.*, 5 Cir. 1970, 430 F.2d 420, Appellate review is limited to the question whether the grant constitutes a clear abuse of discretion. *Id.* The discretion of the lower court extends to the grant

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[32] The district court explained from the bench:

> I will state for the record, although this is not directly before me, that if it were not for the Court's liability to make this finding in the fashion that I have, I would feel compelled to grant a new trial, because I feel that under all of the circumstances of the case, the size of the verdict . . . shock[s] the Court's conscience and also [is] contrary to the weight [of the evidence]. I would grant a new trial rather than a remittitur, because I feel that it would be unfair to both sides for the Court to substitute its own judgment.

Clarence argues that this announcement grants a new trial on the liability issues as well as on damages. His only basis for the assertion is the argument that the phrase "also [is] contrary to the weight" applies to the liability verdict rather than to the decision on damages. We disagree. The phrase is in no way connected grammatically to the question of liability. In addition, the sentence immediately following the phrase shows that the district court considered a remittitur as an alternative response to granting a new trial. This would be an alternative only if the new trial order were limited to the damage issue. The district court decided against a remittitur because it did not want to substitute its judgment for that of the jury, rather than because a remittitur could not adequately conform the jury's verdict on liability to the weight of the evidence.

of a new trial on damages. *Willitt v. Purvis*, 5 Cir. 1960, 276 F.2d 129.

The district court correctly instructed the jury on the issue of damages. It limited the jury to the consideration of the actual damages suffered by Milton, as required by section 28(a) of the Act, 15 U.S.C. § 78jb(a) (1970). *Accord, Affiliated Ute Citizens v. United States*, 1972, 406 U.S. 128, 155, 92 S.Ct. 1456, 31 L.Ed.2d 741; *Richardson v. MacArthur*, 10 Cir. 1971, 451 F.2d 35; *Myzel v. Fields*, 8 Cir. 1967, 386 F.2d 718, *cert. denied*, 1968, 390 U.S. 951, 88 S.Ct. 1043, 19 L.Ed.2d 1143. Generally, a defrauded seller may recover the difference between the price for which he sold his stock and the price he would have received absent the misrepresentation or omission. *Affiliated Ute Citizens v. United States*, 1972, 406 U.S. 128, 155, 92 S.Ct. 1456, 31 L.Ed.2d 741; *Thomas v. Duralite Co.*, 3 Cir. 1975, 524 F.2d 577. To determine the true value of the stock, subsequent developments may be considered. The jury may consider whether the plaintiff would have held onto his stock absent the misinformation. If the jury decides he would not have consummated the sale, it may then award the difference between the sale price and the value of the stock at a reasonable time in the future. *Myzel v. Fields*, 8 Cir. 1967, 386 F.2d 718; *Janigan v. Taylor*, 1 Cir. 1965, 344 F.2d 781, *cert. denied*, 382 U.S. 879, 86 S.Ct. 163, 15 L.Ed.2d 120. Such a rule conforms to the reasoning of *Bird v. Ferry*, 5 Cir. 1974, 497 F.2d 112, which approved an award of damages based on value rather than out of pocket expense. The plaintiff, an investment club, had lost money given to the defendant, a securities salesman, for investment. The Court approved the somewhat speculative damage award that allowed recovery of the value the investments would have attained had the salesman followed the instructions of the club:

> We see nothing inappropriate in the court's use of a measure of damages calculated to restore the club to the position it would have occupied had the defalcations not occurred.

Id. at 113. Applied to a defrauded seller, this theory would allow a jury to consider the value the stock attained within a reasonable time after the sale.

After correctly instructing the jury, the district court found the $905,000 verdict to be against the weight of the evidence. We cannot say that this is an abuse of discretion.[33] Based on the various computations by the valuation experts, $905,000 appears to be half of what one expert calculated as the "equity" of the hotel. A preconstruction appraisal set the value of the completed hotel at $7,160,000. The hotel cost $5,350,000 to construct. By subtracting the two, a net equity figure of $1,810,000 appears. Half of that is $905,000. By rejecting this total, the trial court did not abuse its discretion; the figure does not take into account discounts normally evaluated in the appraisal of close corporation stock. For instance, Milton's own experts reached values substantially below the verdict when they considered the various discounts. Albert Derbes evaluated the stock by comparing Milton's shares to the twenty percent share of the partnership purchased by Monteleone for $600,000. When discounts for both

the tax benefits of the Monteleone investment and the minority status of Milton's stock were considered, Derbes reached a value of $460,000. When only the tax benefits were discounted, the figure rose to only $658,000. Arguably, at the time Milton sold his stock there were other possible risks such as the prospect that the hotel, which was on the edge of the main tourist section of the French Quarter, might have difficulties because of its location. Moreover, a large number of hotels were either under construction or in the planning stage in New Orleans. Had Milton kept his stock, the evidence suggests that he would have been required to endorse the construction note. A failure would have left him personally liable for the loan. The district court could have reasonably concluded that such factors should have reduced the value of Milton's stock below $905,000. At least, the district court would not abuse its discretion by concluding that the weight of the evidence required such factors to be included in the calculation of damages.

IV.

CONCLUSION

We hold that a reasonable jury could have found that, in the circumstances of this case, Milton Dupuy exercised due diligence in the sale of his stock to Clarence Dupuy. The judgment notwithstanding the verdict of the district court is therefore reversed, and the district court is instructed to reinstate the verdict on Clarence Dupuy's liability. By ordering a new trial on damages,[34] in the alternative, the trial court did not abuse its discretion. The case is therefore remanded to the district court for a new trial on damages.

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[33] We do not embrace any particular damage figure.

REVERSED in part and affirmed in part and REMANDED.

F. Notice Of Order Denying Rehearing, June 6, 1977.

United States Court of Appeals
Fifth Circuit
Office of the Clerk

June 6, 1977

TO ALL PARTIES LISTED BELOW:

No. 76-2667 — Milton E. Dupuy vs.
Clarence O. Dupuy, Jr.

Dear Counsel:

This is to advise that an order has this day been entered denying the petition for rehearing, and no member of the panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the petition for rehearing en banc has also been denied.

See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,

EDWARD W. WADSWORTH,
Clerk

/s/ GLENDA M. HAUCK
Deputy Clerk

cc: Messrs. C. Ellis Henican, Jr.
Andrew I. Brown
Carl W. Cleveland
Mr. Milton E. Brener
Mr. Arthur L. Ballin
Mr. James Dalferes

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[34] As part of his argument for a new trial, the appellee challenges the scienter instruction of the trial court. Because the appellee did not cross-appeal, however, this issue is not properly before the Court and is not included in our remand for a new trial. The district court ordered a new trial only on damages. To award a new trial on liability, then, would alter substantially the rights of the parties under the lower court ruling. Such a change may occur only on cross-appeal. *See United States v. American Ry. Exp. Co.*, 1924, 265 U.S. 425, 435, 44 S.Ct. 560, 68 L.Ed. 1087; *Lettsome v. United States*, 5 Cir. 1970, 434 F.2d 907.